1985 Annual Report

Contents

Corporate Profile

Petro-Canada, formed by an Act of Parliament in 1975, is wholly owned by the Government of Canada. Operations began on January 1, 1976. The Corporation is primarily engaged in oil and gas exploration and production, and the transportation, refining and marketing of hydrocarbons for Canadian needs.

Petro-Canada is the largest Canadian-owned company in the petroleum industry and the only Canadian-owned oil and gas company with a national marketing network. At year-end 1985, Petro-Canada had assets of $8.8 billion and employed 10 565 people. The Corporation ranks among the top five companies in all commonly used operating measures in exploration and production, and is one of the nation's top refiners and marketers of petroleum products.

March 31, 1986

The Honourable Pat Carney, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Canada

Dear Minister:

On behalf of the Board of Directors I am pleased to present Petro-Canada's Annual Report for the fiscal year ended December 31, 1985.

In accordance with the provisions of the Financial Administration Act, the Report includes the consolidated financial statements together with the auditors' report thereon.

Yours sincerely,

W.H. Hopper
Chairman of the Board
and Chief Executive Officer

Board of Directors

Wilbert (Bill) H. Hopper
Chairman of the Board
and Chief Executive Officer
Petro-Canada
Calgary, Alberta

Edward M. Lakusta
President
and Chief Operating Officer
Petro-Canada
Calgary, Alberta

Robin Abercrombie
Consultant
Valhalla Energy Corporation
Vancouver, B.C.

Alfred E. Barroll
Consultant
A.E. Barroll Resource
Consultants Ltd.
Calgary, Alberta

† **Jean Bazin, Q.C.**
Senior Partner
Byers, Casgrain
Barristers and Solicitors
Montreal, Quebec

Rudolph Bratty, Q.C.
Senior Partner
Bratty and Partners
Barristers and Solicitors
Downsview, Ontario

Roy Victor Deyell, Q.C.
Senior Partner
McLaws and Company
Barristers and Solicitors
Calgary, Alberta

Anne R. Dubin, Q.C.
Senior Partner
Tory, Tory, DesLauriers
and Binnington
Barristers and Solicitors
Toronto, Ontario

*† **William McBurney Elliott, Q.C.**
Senior Partner
MacPherson, Leslie and Tyerman
Barristers and Solicitors
Regina, Saskatchewan

* **John Lundrigan**
Consultant
Lundrigan Consulting Services Ltd.
St. John's, Newfoundland

† **H. Harrison McCain**
Chairman of the Board
McCain Foods Limited
Florenceville, New Brunswick

* **Jocelyne Pelchat**
Vice-President, Dailies
Quebecor Inc.
Montreal, Quebec

† **David Read**
Businessman
McDonald's Restaurants Ltd.
Dartmouth, Nova Scotia

James Robertson
Businessman
Mack Travel Ltd.
Inuvik, N.W.T.

† **Paul M. Tellier**
Deputy Minister
Energy, Mines and Resources Canada
Ottawa, Ontario
(resigned Aug. 12, 1985)

* Audit Committee Member
† Executive Committee Member

Senior Officers

Wilbert (Bill) H. Hopper
Chairman of the Board
and Chief Executive Officer

Edward M. Lakusta
President
and Chief Operating Officer

David P. O'Brien
Executive Vice-president

Robert J. Mayo
President
Petro-Canada Products

James M. Stanford
President
Petro-Canada Resources

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Petro-Canada
P.O. Box 2844
Calgary, Alberta T2P 3E3
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Chairman's Message

We have now been through ten dramatic years at Petro-Canada – years in which the industry has seen remarkable challenges, changes and opportunities. Economic, political and lifestyle trends, both in Canada and internationally, have forced companies engaged in the oil and gas business to alter their direction and look at things in new ways. Successful companies have been those with the capability to respond quickly to new opportunities. In the years ahead, that will remain an enduring criterion for success.

For Petro-Canada, 1985 was a year of adjusting to these changes. In financial terms, earnings were modest as expected, although the Corporation continued to generate substantial cash flow. In addition, Petro-Canada paid its first common share dividend to the Government of Canada. The most notable achievements of the year were in restructuring the Corporation's asset base. These actions position the Corporation with the flexibility, breadth and balance needed for success, whatever challenges the future presents.

During 1985, the industry faced an uncertain and difficult business environment. An oversupply in world oil markets produced unpredictable and generally declining crude prices. The Canadian oil and gas industry is not isolated from these world-wide circumstances, and is in the process of adjusting to weak demand and volatility in the prices of crude oil, natural gas and refined petroleum products.

In the exploration and production business, Western Canada's conventional operations resisted these negative market pressures, but 1985 activity levels are not likely to be sustained. The economic viability and timing of costly frontier projects, which will play the major role in enhancing Canada's long-term energy security, will depend on the world price of crude oil and fiscal arrangements with governments.

Profitability in the refining and marketing business was constrained by overcapacity. Changes are necessary to allow for adequate returns and the continued investments needed to maintain services required by the public.

Weaknesses in the business environment were offset to some extent by initiatives on the part of federal and provincial governments. Substantial deregulation was achieved in both oil and natural gas. The increased reliance on market forces encourages industry to pursue new opportunities that will improve Canada's energy security.

Federal-provincial agreements have established a climate of understanding within which the industry can operate more confidently. Provincial governments in Western Canada have revised royalties and incentives to encourage further exploration and development. In addition, the announcement of a new frontier energy policy promises to streamline regulations governing Canada Lands and establish non-discriminatory terms which are profit-sensitive.

Petro-Canada appreciates the implications of this business environment. To keep the combination of business and financial risks within acceptable limits, the Corporation continues to diversify its asset base and improve the balance between its short and longer term investments. Petro-Canada's strong and growing position in Western Canada will provide substantial ongoing cash flow. This in turn permits the Corporation to pursue its interests in riskier, long lead-time frontier projects.

For most of its ten years, the Corporation has been a leader in frontier activity, with considerable success. Where the economics are viable, Petro-Canada will continue to work towards development of the most promising opportunities in the East Coast offshore, the oil sands and heavy oil.

In doing so, Petro-Canada will ensure that it maintains a sound financial footing, consistent with the Federal

Government's position that Petro-Canada is to act like a corporation in the private sector. The Corporation's investment plans must meet the test of preserving established financial standards under all plausible business conditions.

Petro-Canada believes that, as its operations expand, the Corporation will require additional equity funds. A special committee of the Board of Directors has been established to determine the best method of securing this new equity capital. We are pleased that the Federal Government is actively examining a proposal for a share issue to the public.

While commercialization of frontier reserves is important for Petro-Canada, today's declining world oil price makes the pace and extent of development uncertain. In the light of this changed business environment and Petro-Canada's concentration on projects with near-term potential, it is clear that some frontier assets will not be developed in the foreseeable future. During 1985, the Corporation registered unusual charges against earnings of $865 million after income taxes, most of which consisted of write-downs that reflect these circumstances.

Concerning Petro-Canada's performance in 1985, several achievements should be highlighted.

At the end of September, Petro-Canada concluded an agreement with Gulf Canada Limited for the purchase of Gulf's refining, transportation and marketing assets west of Quebec. This acquisition makes the Corporation a leader among petroleum product marketers in every region of the country, and positions Petro-Canada for healthy earnings when the business environment improves.

In Western Canada, where crude oil and natural gas production provides the greatest share of the Corporation's cash flow, activity remained strong in 1985, with several new discoveries brought on stream. During the year, three major construction projects – the Wolf Lake in situ oil sands project, the Brazeau River sour gas processing plant, and the Taylor natural gas liquids plant – were completed and commenced operations.

Petro-Canada made further progress in exploring for oil off the East Coast. A well drilled to delineate Petro-Canada's 1984 Terra Nova oil discovery yielded very encouraging test results. The Corporation also announced an oil discovery at its West Ben Nevis well and, later in the year, participated in the nearby North Ben Nevis oil discovery.

This year of growth and adjustment has been made easier by the hard work of everyone at Petro-Canada. Our employees consistently demonstrated professionalism and dedication. The members of the Corporation's new Board of Directors provided effective direction to the Corporation through their diversity of backgrounds and regional perspectives. We especially thank Paul Tellier for more than five years of distinguished service on the Board while he was deputy minister of the Department of Indian and Northern Affairs and the Department of Energy, Mines and Resources. Mr. Tellier resigned from the Board during 1985 following his appointment as Clerk of the Privy Council.

Finally, we recognize that the loyalty of Canadians remains fundamental to our success. The people of Canada have shown they appreciate our Canadian presence in the marketplace. They have welcomed the opportunity to support Petro-Canada as a vehicle for the development of the nation's energy. Throughout our ten years, we have appreciated and drawn strength from this support.

W. H. Hopper
Chairman of the Board
and Chief Executive Officer

March 31, 1986

Ten Decisive Years

In just ten years, Petro-Canada has grown from three employees working out of a Calgary hotel room into one of Canada's most significant corporations, playing a major role in every aspect of the oil and gas industry. Key decisions at critical points along the way enabled Petro-Canada to reach the leading position it holds today.

Profitable Western Canadian Operations Developed

Petro-Canada's early priorities were in offshore and Arctic exploration and in the oil sands. But success in those long-term ventures required the cash flow and operating experience that would come from a solid base of exploration and production operations in Western Canada. To this end, the Corporation purchased Atlantic Richfield Canada Ltd. in 1976, Pacific Petroleums Ltd. in 1979, and Petrofina Canada Inc. in 1981. From this base of assets and expertise, Petro-Canada conducted aggressive exploration and development programs and built up a strong and sustainable source of cash flow.

Frontier Exploration Emphasized

Petro-Canada's initial orientation arose from national concerns raised by the energy crises of the 1970s. Canadians needed the security of new sources of energy. At that time, exploration in Canada's frontiers – the Arctic and offshore regions – had met with little success, and industry activity was declining. Petro-Canada quickened the pace of frontier work by investing in a number of important exploration programs. To establish a Canadian capability in the offshore, Petro-Canada became the operator of a drilling program off Labrador, and then began its own operations off Nova Scotia and Newfoundland. The Corporation's efforts to accelerate exploration led to discoveries such as Terra Nova, Hibernia and Venture.

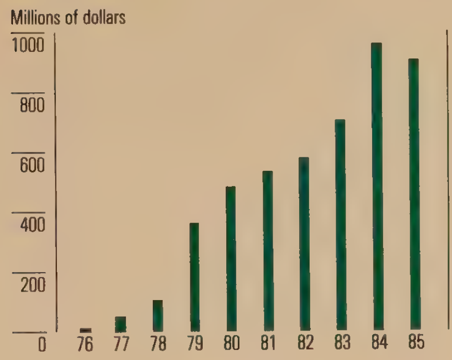
Strong Oil Sands Position Achieved

Providing new energy supplies for Canadians meant further development of another large energy source: the oil sands of Western Canada. Petro-Canada gained its 17 per cent interest in the Syncrude oil sands project by assuming control of the Federal Government's share in 1976 and later acquiring an additional five per cent through the purchase of Petrofina. The Corporation also developed a strong land position through the Atlantic Richfield, Pacific and Petrofina acquisitions. Since then, Petro-Canada has been an active player in mineable and in situ oil sands development.

A Canadian Identity Established in Marketing

Petro-Canada's early acquisitions gave it an entry into refining and marketing. Capitalizing on the opportunity this provided, Petro-Canada reidentified its service stations with a distinctive maple leaf logo, and emphasized in its communications a uniquely Canadian position and orientation. The public responded enthusiastically and sales of petroleum products rose. With the acquisitions of portions of BP Canada Inc. in 1983 and Gulf Canada Limited in 1985, the Corporation created a nation-wide network that can fully serve customers in every region. Petro-Canada's Canadian identity continues to be a strong element of the Corporation's success in refining and marketing.

Petro-Canada's Internally Generated Cash Has Grown Dramatically



Dealers and Agents Supported as Independent Business People

The Corporation realized customer service was essential for long-term business success in marketing refined products, and resolved to support its dealers and agents as independent business people with strong links to the local community. Putting dealers' names on outlets symbolized this commitment, while company programs encouraged dealer involvement with community activities. Many company-owned outlets were sold or leased to local operators. These actions have gained for Petro-Canada a sound reputation for customer service.

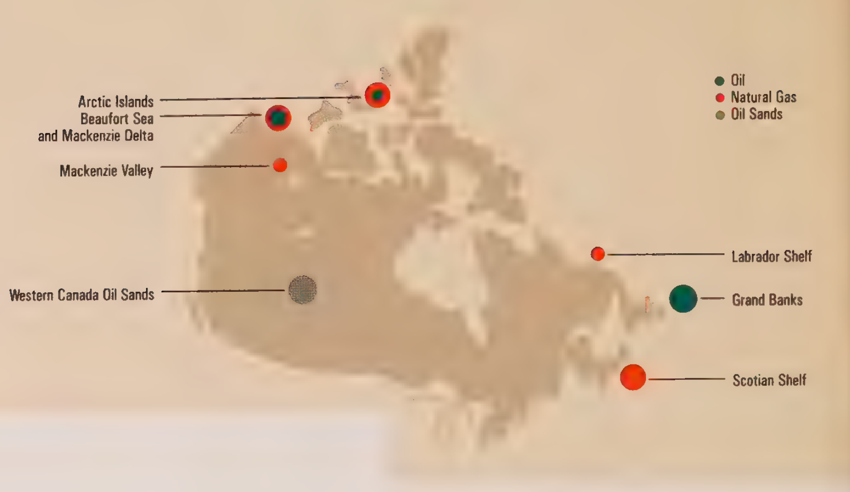
Organization Streamlined for Efficiency and Effectiveness

In the early 1980s, the first signs of a more difficult business environment for the oil and gas industry began to appear. Petro-Canada responded to these early signals by initiating a thorough reorganization and streamlining according to rigorous business objectives. The result was a more tightly structured organization that managed its business efficiently and effectively. In late 1984, an appraisal of Petro-Canada by a national investment house described the Corporation as playing a significant role in the industry while being leanly staffed relative to its integrated competitors.

Commercial Results Emphasized

The Corporation's early mandate led it to undertake frontier exploration and other activities in the national interest. By 1984, a substantial inventory of frontier reserves had been completed. Changes in the business environment made it clear to Petro-Canada and its shareholder that it was time to take a sharper commercial focus, by placing more weight on bottom-line results and moving from extensive exploration towards the development of economically viable resources. The new Federal Government, elected in September 1984, also indicated that Petro-Canada was to operate in a private-sector fashion. With a significant presence in all key aspects of the industry, Petro-Canada is advancing in a careful manner, evaluating opportunities on a commercial basis and adapting effectively to changing market conditions.

Future Energy Resources



Petro-Canada Highlights

Petro-Canada's financial results for 1985 reflect internally generated cash of $906 million and earnings before unusual items and dividends of $174 million. These results are somewhat below the record levels achieved in 1984, largely because of lower prices resulting from the highly competitive market conditions which prevailed during 1985.

Write-downs Reflect Commercial Focus

Petro-Canada's earnings for 1985 were reduced by $865 million after income taxes in unusual charges, consisting mainly of write-offs of the book values of certain frontier assets. This step followed a reassessment of all business investments, taking into account the decline in world oil prices and the Corporation's commercial orientation.

In recent years, the focus of Petro-Canada's activity in the frontiers has changed. As part of the Corporation's early responsibility, investments were directed towards establishing an inventory of Canada's frontier resources and determining the likely costs associated with their development. Successes in this earlier work, together with reduced energy demand and declining world oil prices, give Canadians a reasonable assessment of the extent of the country's hydrocarbon reserves, and an indication of which reserves can be developed economically. Petro-Canada is now concentrating on bringing to commercial development those projects that promise returns in the short to medium term. The Corporation has therefore written off certain properties in frontier areas that are not commercially viable under existing conditions. In addition, it has provided for anticipated losses on contracted offshore drilling vessels and ancillary equipment.

While the attractiveness of frontier areas is limited at present, many discoveries hold development potential in the long term. Canadians now have the security that comes with significantly increased knowledge of the country's energy reserves. Resources that could be developed in the future include additional oil sands deposits in Western Canada, as well as oil and gas reservoirs in the Mackenzie River Valley and Delta, the Beaufort Sea, the Arctic Islands and in offshore Labrador, Newfoundland and Nova Scotia. Petro-Canada will continue to be a significant player in Canada's frontiers, evaluating the economic and technical viability of discovered reserves and pursuing commercial opportunities as they arise.

Petro-Canada has been active and successful in exploration off Canada's East Coast.

Petro-Canada has expanded its range and quality of services for customers. Innovative cloth brushes are being tested in some car washes.

Gulf Acquisition Most Significant Investment of the Year

The most significant investment of 1985 was Petro-Canada's acquisition of the downstream portions of Gulf Canada Limited located in Ontario, Western Canada, the Yukon and the Northwest Territories. Under the agreement concluded on September 30, 1985, Petro-Canada purchased refining, transportation and marketing assets and working capital for $611 million. Both internal resources and conventional borrowing were used to provide the funding. As part of the agreement, Petro-Canada will acquire, by early 1986, the Gulf refinery in Edmonton for a further $275 million.

These additional refining and marketing facilities complement Petro-Canada's existing operations and improve Petro-Canada's competitive position across the country, particularly in the West. As a major force in the refined products business, Petro-Canada can gain efficiencies and provide customers with a comprehensive offering of quality services. When considered in conjunction with Petro-Canada's exploration and production operations, this new strength in refining and marketing gives the Corporation an excellent overall position. In the uncertain business environment that is expected to continue, Petro-Canada can pursue opportunities equally well in both industry sectors.

Organizationally Sound

Throughout 1985, management's strategies regarding business and financial positioning were accompanied by careful attention to employee development, organizational effectiveness and employee safety.

In addition to ongoing employee development planning, a process for executive development was established. A special committee oversees succession planning among high-potential managers and senior executives.

Organizational realignments followed evaluation of the effectiveness with which each division operates. In the Products division, the core functions such as control, planning and engineering were strengthened to ensure more effective operation of the three financially accountable regional units. Within this context, and to improve executive communications, it was decided to transfer some 250 senior positions from Toronto to Calgary during 1986. In the Resources division, organizational changes were made to respond to emerging trends in the business and provide better opportunities

Women's car care clinics are one of the ways in which dealers get involved in the community.

for the professional growth and development of employees.

With respect to employee safety, the Corporation participates in the International Safety Rating System. An excellent record was achieved in 1985 as a result of this structured approach to setting safety standards and auditing performance.

Involved in the Community

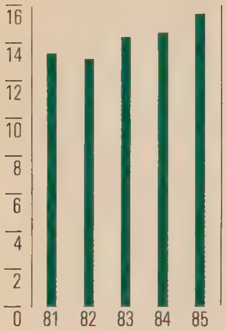
Petro-Canada remains strongly committed to ensuring that its business activities benefit Canada and Canadians, particularly in regions where the Corporation has a strong operational presence. The expansion of employment and business opportunities for Canadians is a consideration in all of the Corporation's investment decisions.

In 1985, the Corporation's exploration program in the Mackenzie Valley generated significant opportunities for Northerners. Local residents comprised over half of drilling and seismic crews, and more than 60 northern businesses provided a variety of goods and services to the program – including camp rentals, land clearing, transportation, parts, repair and maintenance services, and heavy equipment rentals.

Petro-Canada's frontier exploration work has resulted in significant opportunities for regional firms which supply, on a competitive basis, exploration-related goods and materials. In addition, Dalhousie and Memorial Universities in Atlantic Canada were given funds to establish two new research and education programs in offshore sciences. Other educational institutions were assisted in providing Canadians with training in the highly skilled trades associated with the offshore.

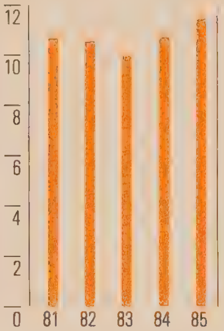
During the year, Petro-Canada's many sponsorships and donations continued to play a role in communities across the country where the Corporation and its employees are active. Once again, Petro-Canada's involvement in the United Way/Centraide campaign was outstanding. Employee contributions along with a matching corporate grant constituted the largest single donation ever received by the United Way in Calgary. Youth-related activities – which regularly include sponsorship of soccer and baseball teams by dealers – received special attention in connection with the International Youth Year. The Ronald McDonald House fund and the Bluenose II Foundation were among the causes supported by Petro-Canada's customers through innovative retail promotions.

Record Achieved in Gross Production of Crude Oil and Natural Gas Liquids*



* excludes natural gas liquids from straddle plants

Gross Production of Natural Gas Reached Record Level



Production Summary*

Year ended December 31, 1985	Oil *(thousands of cubic metres)*	Natural Gas Liquids *(thousands of cubic metres)*	Natural Gas *(millions of cubic metres)*
Alberta	4 447	1 546	2 810
Conventional	3 179	609	2 810
Syncrude	1 268	–	–
Empress	–	937	–
British Columbia	228	45	1 404
Conventional	228	31	1 404
Taylor	–	14	–
Saskatchewan	235	–	10
Manitoba	3	–	–
Total Canada	4 913	1 591	4 224
International	134	–	–
Total	5 047	1 591	4 224

* Corporation's share before royalties

Resources Division Highlights

Nineteen eighty-five was a successful year for Petro-Canada's Resources division. Good operating results were achieved by diversifying sources of cash flow, rapidly bringing new facilities on stream in Western Canada, and moving forward with longer-term projects in a steady but prudent manner. Consistent with the Corporation's overall strategy, these activities continued the division's thrust towards positioning for sustained profitability.

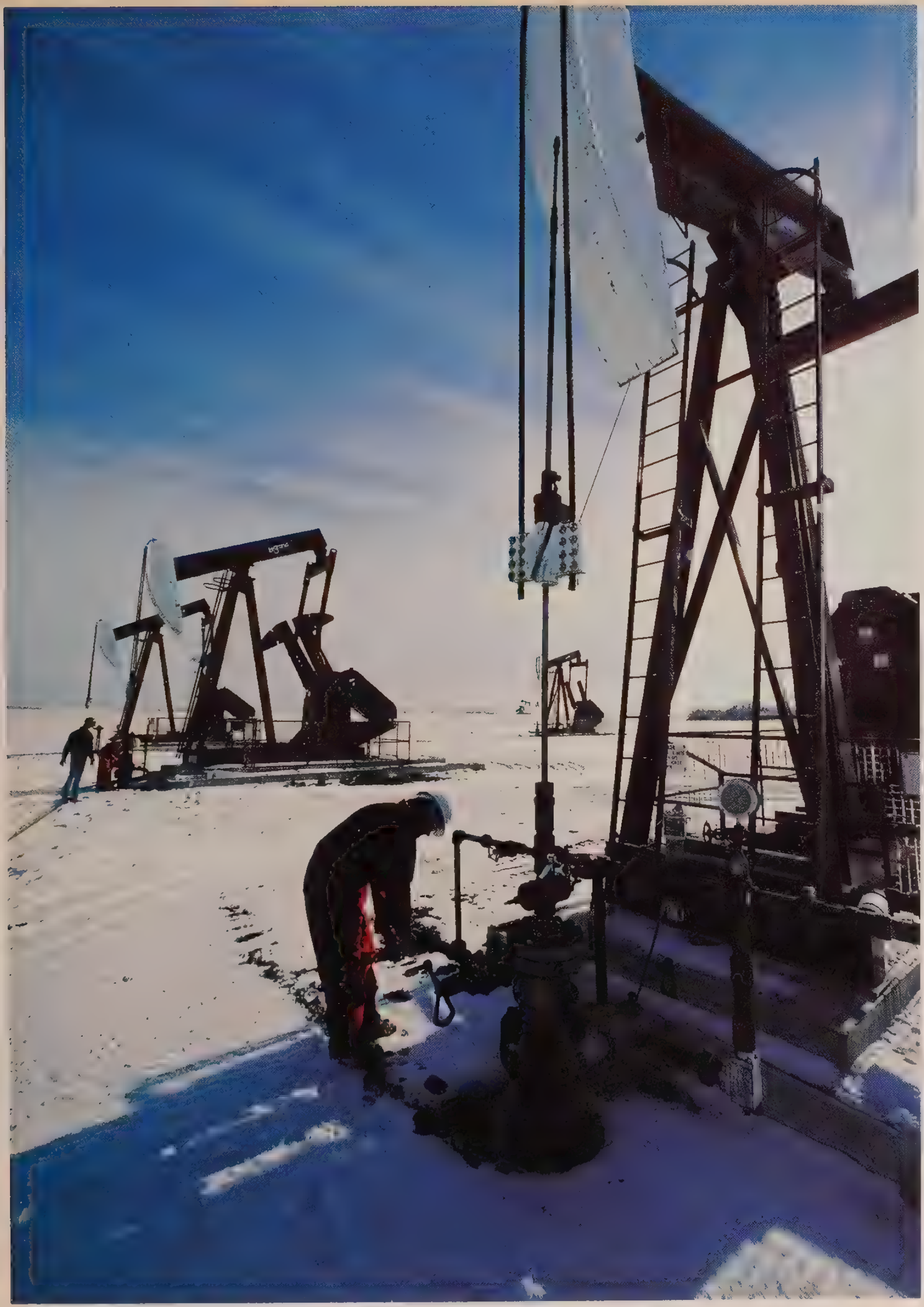
The strong operating results were particularly significant given the changing business conditions the industry faced during the year. Oil prices were soft and unpredictable, making many companies reluctant to proceed with long-term projects. Pipeline capacity constraints led to shut-in oil production, while export prices for natural gas declined substantially. On the positive side, the Western and Atlantic Accords, the deregulation of domestic crude oil after June 1, the easing of controls on natural gas marketing, and new incentive systems in the producing provinces contributed by year-end to a more favourable climate for the industry.

Petro-Canada's Most Active Year in Western Canada

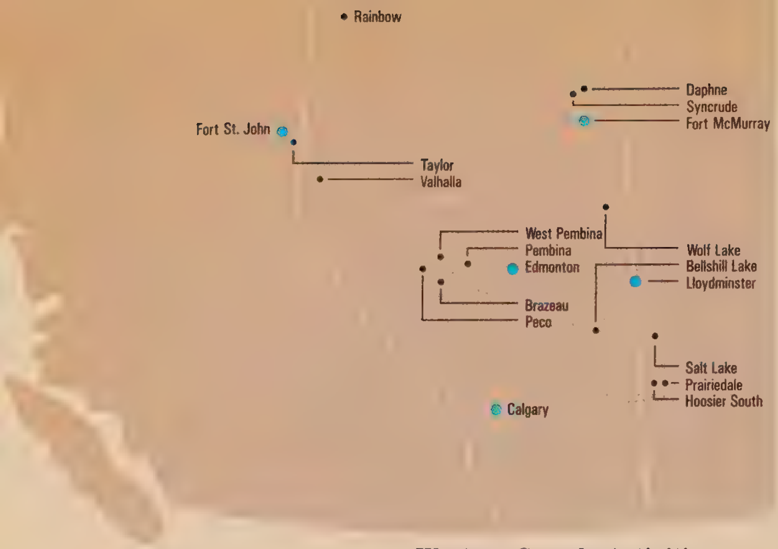
Petro-Canada's Western Canada operations provide a strong and diversified base for the Resources division's business. In 1985, Petro-Canada continued to focus on the most prospective areas, emphasizing early cash generation and operating efficiencies.

Petro-Canada participated in the drilling of 166 exploratory wells, yielding 52 oil wells, 51 gas wells, and 63 dry and abandoned wells. This strong success rate of 62 per cent, up from last year, was achieved well within competitive finding costs. Out of 565 development wells, 518 were successful oil or gas wells, giving a success rate of 92 per cent. Significant additions to oil reserves include those made at Prairiedale, Salt Lake and Hoosier South in western Saskatchewan and in the Rainbow area of northwestern Alberta. Gas discoveries were made in British Columbia and Alberta, with major finds at the Peco, Pembina and West Pembina areas west of Edmonton. In addition, Petro-Canada continued to strengthen its asset base with strategic land acquisitions.

Both total liquids production and natural gas production reached record levels in 1985. Particularly noteworthy were the strong increases in the production of natural gas, natural gas liquids and synthetic crude oil.



At Bellshill Lake, one of Petro-Canada's major oil fields, production volumes were improved by drilling 49 new wells.



Western Canada Activities

The new Brazeau River sour gas plant produces valuable condensate, liquefied petroleum gases and sulphur.

Petro-Canada continues to update the technology which it uses to support its operations. In 1985, the research and development functions were integrated into the exploration and production groups. This move facilitates direct application of research results and improved technology, allowing better analysis of opportunities and greater efficiencies in operations.

New Projects Strengthen Western Canadian Operations

A sour gas plant, a natural gas liquids extraction plant and three oil field development schemes were significant among the investments made during the year.

The Brazeau River sour gas plant, located 160 kilometres southwest of Edmonton, commenced operations in late summer. Operated and 42.5 per cent owned by Petro-Canada, the facility processes about 700 000 cubic metres a day of gas to extract over 800 cubic metres a day of condensate and liquefied petroleum gases, plus 80 tonnes a day of sulphur. Residue gas is reinjected into the formation to maintain pressure and enhance production of the high-value liquids. The plant incorporates advanced computerized control systems to maximize efficiency and profitability, as well as reduce emissions.

Petro-Canada is a 50 per cent owner of a natural gas liquids plant which was commissioned late in 1985 at Taylor, in northeastern British Columbia. The plant straddles the pipeline leading from Taylor to Vancouver, extracting up to 1 080 cubic metres a day of propane, butanes and pentanes plus.

Elsewhere, efforts were made in 1985 to push ahead with development of promising discoveries. At Valhalla, 60 kilometres northwest of Grande Prairie, Alberta, Petro-Canada initiated a water-flood enhanced recovery program for the oil field it discovered in 1981. This project has boosted proven reserves of high-quality light crude oil from 1.2 million to 4.8 million cubic metres.

Development proceeded swiftly at Salt Lake, Saskatchewan, following Petro-Canada's discovery well in September, 1984. Five oil wells were on stream by the end of 1984. At year-end 1985, 46 wells were producing 340 cubic metres a day of heavy oil.

At Bellshill Lake, in east-central Alberta, a program to optimize oil production was completed. Forty-nine new wells were drilled, accelerating the rate of oil production in one of Petro-Canada's major oil fields.

Oil Sands Important Now and for the Future

Petro-Canada's oil sands interests are currently making appreciable contributions to the Corporation's business. In 1985, Petro-Canada registered its first commercial production from in situ oil sands, produced with other companies record volumes of synthetic crude oil from the Syncrude plant, and continued to study possibilities for major additions to its oil sands mining capability.

Commercial production began in April 1985 at the Wolf Lake in situ oil sands project in northeastern Alberta. This partner-operated project, in which Petro-Canada has a 50 per cent interest, uses steam injection technology to recover approximately 1 100 cubic metres per day of bitumen. Over 100 permanent jobs have been created by Phase I of the project. Over the long term, the Wolf Lake project could be

The synthetic crude oil produced by the Syncrude project generates strong cash flow for Petro-Canada. The project is also an industrial customer for Petro-Canada's lubricants and light oils.

Land Summary

As at December 31, 1985	Gross	Net
	(thousands of hectares)	
Non-Frontier Areas		
British Columbia	1 352	692
Alberta*	3 653	1 623
Saskatchewan	192	124
Manitoba	149	76
Ontario	31	16
Frontiers		
N.W.T.	5 790	5 240
Beaufort Sea	3 163	456
Hudson Bay	429	53
Arctic Islands**	6 845	954
East Coast Offshore	14 631	7 415
West Coast Offshore	2 358	2 358
International	3 407	1 108
Total***	42 000	20 115

* includes oil sands leases
** excludes land held by Panarctic Oils Ltd.
*** excludes coal leases

Proven Reserves Summary

As at December 31, 1985	Oil		Natural Gas Liquids		Natural Gas	
	Before Royalties	After Royalties	Before Royalties	After Royalties	Before Royalties	After Royalties
	(thousands of cubic metres)		*(thousands of cubic metres)*		*(millions of cubic metres)*	
British Columbia	2 890	2 244	831	672	31 423	28 103
Alberta†	39 991	29 995	6 614	4 821	66 980	49 392
Saskatchewan	2 463	1 997	–	–	419	367
Total Canada	45 344	34 236	7 445	5 493	98 822	77 862
International	478	478	–	–	–	–
Total excl. Synthetic	45 822	34 714	7 445	5 493	98 822	77 862
Synthetic Crude††	39 102					
Total	84 924					

† conventional and in situ oil sands
†† in view of the subjectivity associated with the determination of royalties for production from the Syncrude project, the Corporation has not presented its synthetic crude oil reserves net of royalties

expanded in phases to meet future energy demands.

The Syncrude oil sands mining project achieved record production in 1985. The plant, 17 per cent owned by Petro-Canada, is located near Fort McMurray, Alberta. Petro-Canada's production share of fully upgraded synthetic crude totalled 1.27 million cubic metres, 15 per cent over the previous record established in 1983. Work proceeded in 1985 on expanding plant capacity to 22 000 cubic metres a day. This Capacity Addition Project will cost an estimated $720 million, of which Petro-Canada's share is about $122 million.

During 1985, Petro-Canada continued to study the feasibility of an oil sands mining project to be located on the Daphne oil sands leases some 65 kilometres north of Fort McMurray, Alberta.

Tangible Progress in the Frontiers

In 1985, a successful program focussing on the most prospective frontier areas resulted in several substantial finds. This increased the Corporation's potential reserves and clarified which opportunities will be the most attractive for development.

Most important for the Corporation was the Terra Nova K-07 well, a step-out to Petro-Canada's 1984 oil discovery off the coast of Newfoundland, and 75 per cent owned by Petro-Canada. With cumulative flow rates of 1 273 cubic metres a day, it improved the Corporation's confidence that the field contains substantial reserves capable of being developed. At year-end, an additional delineation well was being drilled at Terra Nova I-97.

The Ben Nevis discoveries, adjacent to Terra Nova, were also substantial. Petro-Canada holds a 37.5 per cent interest in West Ben Nevis B-75 and a 25 per cent interest in North Ben Nevis P-93.

The Corporation is a 25 per cent participant in the largest East Coast discovery to date, at Hibernia off Newfoundland. During 1985, the Hibernia project's Development Plan and Environmental Impact Statement were filed with the Federal and Newfoundland Governments. The plan will require an investment of $4 billion before project start-up in the early 1990s, and will include a concrete gravity base structure that will support production facilities.

On the Scotian Shelf, Alma K-85 and Thebaud I-93 were successful delineations of earlier gas discoveries. An additional well, North Triumph G-43, was drilling at year-end and subsequently was tested as a successful gas discovery. This exploration is directed towards increasing reserves adjacent to Sable Island, where three natural gas fields may be developed in connection with the Venture project when economic conditions permit. Applications to export gas to northeastern United States markets were filed with regulatory authorities during the year.

In Northern Canada, Petro-Canada participated through a subsidiary in the Bent Horn project, which resulted in the first shipment of hydrocarbons from the Arctic Islands to southern markets.

In the Western Arctic, promising exploration is continuing in the Mackenzie Valley and Delta. In the Mackenzie Valley, Petro-Canada drilled

Explorationists use computerized interactive work stations to interpret complex three-dimensional seismic data. High-quality exploration prospects can now be identified in a matter of days.

an important gas discovery at Tweed Lake M-47. A follow-up drilling program is planned for early 1986.

On the Tuktoyaktuk Peninsula, Petro-Canada participated in a significant new oil discovery at Tuk J-29. To assess the extent and quality of the reserves, a number of delineation wells were under way at year-end, and more are planned for early 1986.

Building an International Position

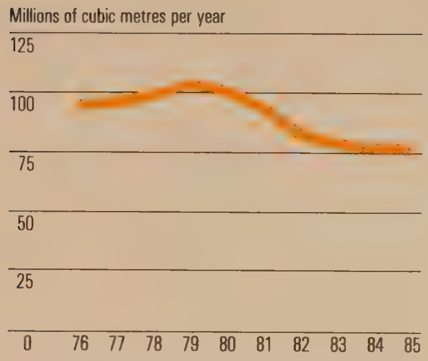
Petro-Canada's primary thrust is to find and develop energy resources in Canada. At the same time, however, it is involved in a number of prospective international areas, with possibilities for early cash generation and return on investment. This strategy provides opportunities for profit and new sources of supply for Canada, while keeping Petro-Canada in touch with the latest technology, especially for offshore exploration. This international presence gives Petro-Canada greater flexibility in responding to changing conditions.

In 1985, the Corporation maintained its involvement in a drilling program off China, though with disappointing results. Petro-Canada also acquired attractive landholdings in Colombia and Indonesia, and became the operator of a promising block off Papua New Guinea, where a seismic program will be carried out in 1986.

The Corporation's interest in the Casablanca oil field off the coast of Spain continued to be profitable. Two new wells were brought on stream in 1985.

Petro-Canada also provides expertise and technological services on a cost recovery basis for Petro-Canada International Assistance Corporation (PCIAC). A financially independent subsidiary of Petro-Canada with its own board of directors, PCIAC is funded by the Government of Canada as a vehicle for foreign aid. During 1985, PCIAC carried out a number of exploration and development programs in developing countries. Such efforts earn goodwill for Canada, give a higher international profile to Canadian energy expertise, and provide significant business opportunities for the Canadian oil and gas community.

Industry Sales of Oil Products Have Dropped



Products Division Highlights

During 1985, Petro-Canada adjusted its operations to meet the challenges of a difficult business environment. However, financial results for the year were still not strong.

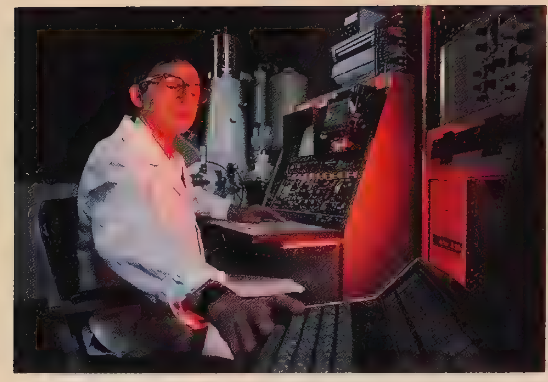
During the early 1980s, Canadian demand for petroleum products dropped significantly. Over the last two years, this downward trend has levelled out. Nevertheless, current demand remains approximately 25 per cent below 1979 levels. The refining and marketing business continues to be characterized by low refinery and service station utilization, high costs, and facility closures. Surplus capacity has intensified competition and weakened prices, with companies relying heavily on advertising and promotions to hold market share. This situation produced unsatisfactory earnings for the entire industry, including Petro-Canada.

For the balance of the decade, demand for refined products is generally expected to remain near current levels. Modest growth for some products will be offset by declines in petroleum use for heating; heavy fuel and heating oils both face competition from natural gas and electricity. Demand for gasoline is anticipated to remain stable, while diesel and jet fuel demand, which is closely tied to the state of the economy, is forecast to rise.

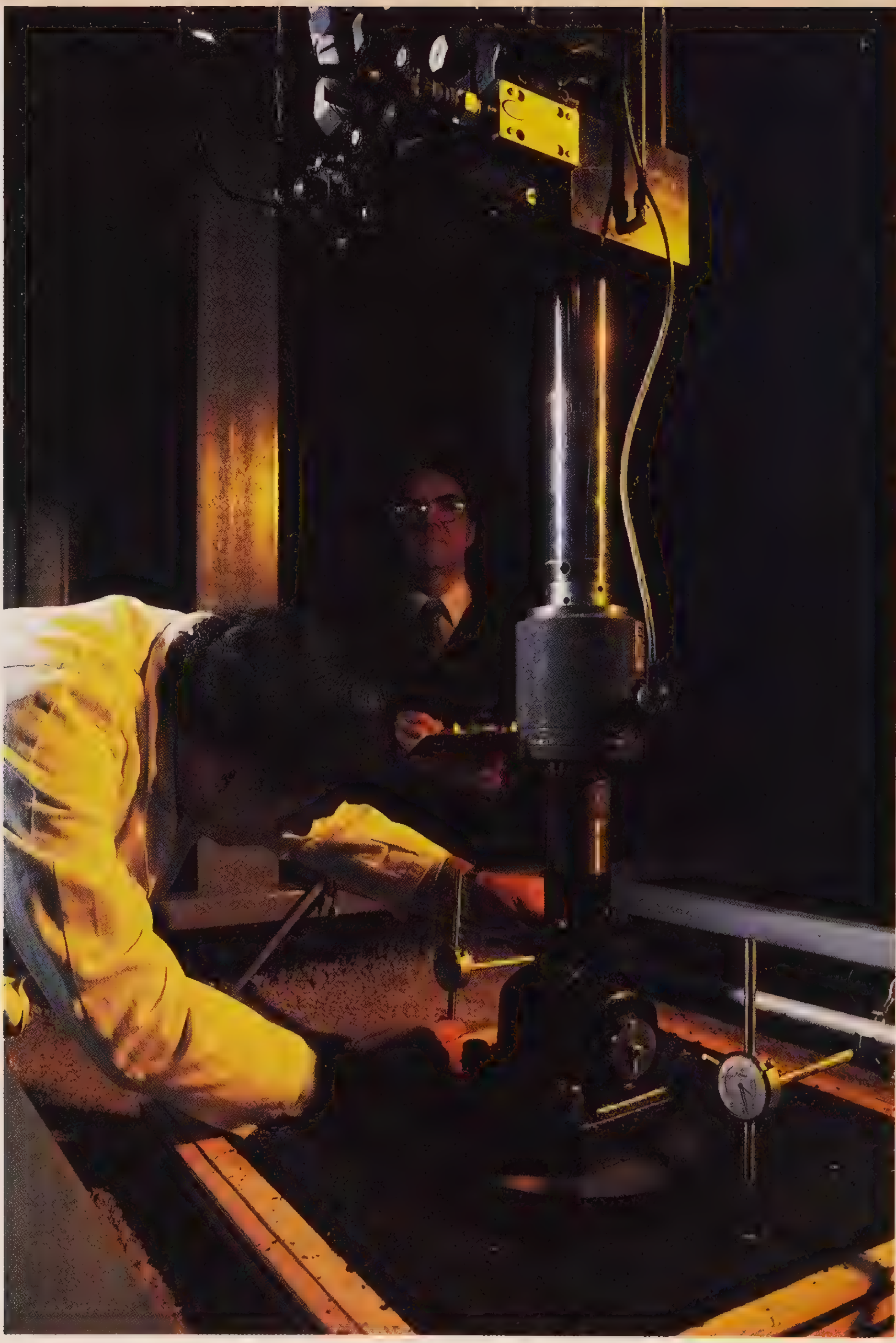
After June 1, 1985, the deregulation of crude oil pricing and markets provided the industry with new opportunities. Refiners are now better able to reduce costs through access to a wider variety of domestic and foreign crude oils and unfinished and finished products.

Through 1985, Petro-Canada has responded to the changing business environment by gaining a more diversified and balanced presence in the business, enhancing retail service to gain customer loyalty, and applying technology to reduce costs and capture opportunities.

The Gulf Acquisition Brings Strength, Balance and New Opportunities
The acquisition of portions of Gulf Canada Limited on September 30, 1985 added both strength and balance to Petro-Canada's existing refining, transportation and marketing assets. This move improves Petro-Canada's ability to



Customers benefit from product development and testing at the Sheridan Park, Ontario, research centre.



An automated warehouse for packaged oil products provides an efficient link between manufacturing and retail sales.

serve its customers and gives Canadians better access to the Corporation's services.

In Western Canada, Petro-Canada began the year with a small distribution network and a limited presence in many markets. Now, an excellent network of bulk plants, farm centres and service stations gives Petro-Canada a leading market share and effective access to the total western market. The asphalt plant in Moose Jaw, Saskatchewan, several pipeline interests, and the balance of the ownership in the Port Moody, British Columbia, refinery increase the Corporation's processing and transportation capabilities. By early 1986, Petro-Canada will also acquire the Edmonton refinery, one of Canada's most efficient and sophisticated facilities.

In Ontario, new service stations in the north, along major highways and in certain urban areas, give the Corporation a comprehensive distribution network. In addition, Petro-Canada acquired a lubricants manufacturing capability and a major research centre.

Besides providing nation-wide balance, the acquisition added breadth to Petro-Canada's product line and the types of services offered to consumers. Petro-Canada now manufactures, markets and provides technical support for a full range of products, benefitting customers in all market segments. At the retail level, the wider service offering includes quick lube facilities and more car washes and convenience stores.

Petro-Canada Starts at the Customer

In its short history, Petro-Canada's Canadian identity and its initiative in the marketplace have attracted strong public support. Petro-Canada recognizes that business success rests on continued customer loyalty, which can be earned only by providing top quality service.

Petro-Canada has reinforced its commitment to customer satisfaction by developing a strong customer service focus throughout the organization. A key management priority in both the head office and the regions, this customer-focussed strategy emphasizes to employees, dealers and associates the vital importance of the customer to the Corporation's overall commercial success.

Through 1985, specific market research programs were initiated to ensure customers' needs are taken into account in business decisions and high retail standards are maintained. To demonstrate commitment to the customer, Petro-Canada emphasized such programs as dealer and agent training, and community involvement.

Petro-Canada now tests, manufactures and markets a full range of lubricants of the finest quality.

Expanded Lubricants Business Enhances Service Offering

Petro-Canada's ability to serve Canadians now has a new dimension. With the Gulf acquisition, Petro-Canada has become a major producer of high quality lubricants. These hydrogen-treated lubricants are known for their exceptional purity and long-life, high-performance characteristics. The unique qualities of these products mean that Petro-Canada can effectively compete in every major retail and industrial market segment for general and specialty lubricants.

Technology Applied to Reduce Costs and Gain Opportunities

Petro-Canada is using the latest tools and innovative procedures to bring its refineries up to the standards that will meet the demands of the marketplace in the late 1980s and the 1990s.

At the Montreal refinery, a new catalytic cracker began operations in November, 1985. This new unit uses modern technology to manufacture gasoline more efficiently than the older unit it replaced. With other projects completed during 1985, the refinery now operates more efficiently and reliably, with improved environmental impact.

Construction of the CANMET demonstration plant at the Montreal refinery was completed and testing began in late 1985. When fully operational, the plant will convert fuel oil into gasoline and distillates.

Engineering studies in 1985 focussed on increasing refinery efficiency through computer control applications and further opportunities for

energy conservation and yield improvements.

Efficiencies in distribution and sales are being achieved both through the development of improved computer systems for inventory management and financial control, and through the integration of business systems. These improvements will be particularly advantageous as the industry faces an increasingly competitive market, where timeliness, operating effectiveness and cost efficiency will be of primary importance.

Petro-Canada is Positioned for Success

During 1985, the key elements of Petro-Canada's response to the changing business environment were the acquisition of the Gulf assets, continued customer focus, and investments to improve the efficiency and reliability of the Montreal refinery. In addition, the Corporation is managing opportunities associated with the deregulation of crude oil pricing and markets.

Further integration of the acquired Gulf assets can be expected to result in new efficiencies during 1986. With a broader and more balanced national presence, Petro-Canada has become a more effective competitor in the refining and marketing business.

A new catalytic cracker allows the Montreal refinery to operate more efficiently.

Financial Review

The Corporation achieved substantial earnings from operations and cash flow results for 1985, although both were below those for 1984. Production of conventional crude oil was marginally below that of 1984 due to pipeline constraints. However, production of synthetic crude, natural gas and natural gas liquids all reached new record levels. Profitability in the refining and marketing segment was severely constrained due to continuing refining overcapacity and highly competitive conditions in the marketplace.

Effective September 30, 1985, the Corporation acquired the refining, transportation and marketing assets of Gulf Canada Limited located west of the Province of Quebec. In comparing the 1985 results with 1984, it should be noted that the 1985 results include those of the former Gulf operations for the last quarter of the year.

In light of the continuing decline in world oil prices and the prospect of lower than anticipated future prices, the Corporation determined that it was appropriate to write down its assets, mainly those associated with exploration in certain frontier regions of Canada. While the regions written off contain very substantial reserves of oil and gas, the Corporation believes that the current and anticipated energy environment is such that significant commercial production is unlikely within a reasonable economic time frame. These frontier exploration items, together with a provision for anticipated losses on contracted offshore drilling facilities, have been charged to earnings and are included in the figure of $865 million captioned "unusual items" in the consolidated statement of earnings. This figure, which is stated net of applicable income taxes, contains other unusual charges, including costs formerly deferred for Arctic pipeline feasibility studies, and process development costs. Details of the unusual items are contained in note 13 to the consolidated financial statements. Since the Corporation was amortizing most of its frontier costs over varying periods, the write-down will result in slightly increased earnings in future years. It should be noted that, while the charge for unusual items reduced the Corporation's net earnings for 1985, it had no effect on cash flow.

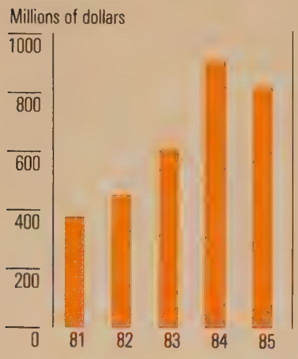
During 1985, the Corporation changed its method of accounting for investment tax credits in accordance with recommendations issued by the Canadian Institute of Chartered Accountants. Investment tax credits, previously recognized as a reduction of the tax provision, are now applied against the cost of the appropriate assets. This change has been applied retroactively and prior years' financial statements restated.

Cash Flow

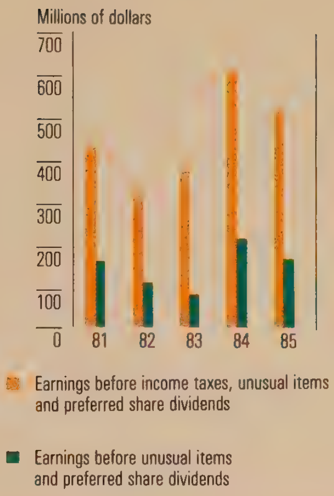
Internally generated cash of $906 million, while substantial, was down from the previous year's record of $968 million due in part to lower contributions from the refining and marketing segment, together with higher financing costs associated with the acquisition of the Gulf assets.

After deducting preferred share dividends, cash available for reinvestment, debt retirement and dividends on common shares was $828 million, down by $40 million or five per cent from 1984.

Internally Generated Cash Available for Reinvestment, Debt Retirement and Dividends on Common Shares



Earnings



The Corporation made a common share dividend payment of $50 million to the Government of Canada during 1985.

The Corporation continues to emphasize cash flow as the principal measure of financial strength and ability to survive and grow in today's uncertain business environment. While investors have traditionally focussed on earnings, it is cash flow – simply the difference between cash received from the sale of the Corporation's natural resources and refined products, and the cash laid out to generate that revenue – that funds the ongoing operations and expansion of the Corporation's various businesses. Cash flow is a more objective measure of financial performance than earnings. The non-cash charges for depletion, depreciation and amortization which are applied against cash flow in arriving at earnings reflect the cost of assets to the Corporation. These non-cash charges are high because the Corporation grew mainly by acquisition during the high-price environment of the last ten years, rather than by internal growth over many decades. Since the excess of the cost of acquired companies over the net book value of those companies is generally not deductible for income tax purposes, the adverse effect on earnings of growth by acquisition is particularly significant.

Earnings

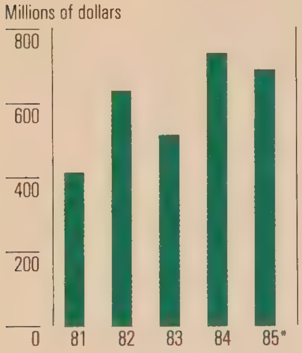
Earnings before income taxes, unusual items and preferred share dividends were $512 million, down by $100 million or 16 per cent from 1984. A provision of $341 million was made for income taxes of which $296 million was deferred and $45 million is currently payable. It will be noted that the effective income tax rate on pretax earnings is high – 66 per cent – compared to the combined federal and provincial income tax rate of approximately 48 per cent. This is because in arriving at taxable income, oil and gas producers are not permitted to deduct royalty payments and Petroleum and Gas Revenue Tax. In addition to this, in the case of the Corporation, the effective income tax rate is increased significantly due to the non-deductibility of the excess of the cost of acquired companies over their net book value, referred to previously.

Earnings before unusual items and preferred share dividends were $174 million, a decrease of $58 million or 25 per cent from 1984.

Earnings were reduced by $865 million as a result of the charge for unusual items. As previously indicated, while this accounting treatment reduced earnings it had no effect on the Corporation's cash flow for 1985.

Dividends of $78 million were paid on the Corporation's redeemable preferred shares, compared with $100 million in 1984. The reduced dividends result from share redemptions and lower dividend rates in 1985.

Capital Expenditures (Net of Petroleum Incentive Program Grants)



*Excludes assets acquired from Gulf Canada Limited

Capital Expenditures

Excluding acquisition of the Gulf assets, capital expenditures on property, plant and equipment, net of Petroleum Incentive Program grants, were $711 million compared with $751 million in 1984.

Capital expenditures on conventional oil and gas properties in Western Canada were $237 million, including $21 million for major programs at Brazeau River and Bellshill Lake. The Corporation's share of expenditures on the Syncrude oil sands mining plant and the Wolf Lake in situ oil sands project were $59 million and $13 million respectively. In addition, $23 million was expended for the construction of a natural gas liquids extraction plant at Taylor, British Columbia. Expenditures in the Canadian frontier areas, mainly in the Grand Banks, Scotian Shelf and Mackenzie/Beaufort regions, totalled $147 million. Downstream capital expenditures were $156 million, including $45 million for the new catalytic cracker at the Montreal refinery.

The refining and marketing assets of Gulf, including related working capital, were acquired for a cash consideration of $611 million. In addition, the Corporation has agreed to purchase Gulf's Edmonton refinery for $275 million. This transaction will be completed early in 1986.

Net Assets

At December 31, 1985, the consolidated assets of the Corporation amounted to $8 846 million. These consisted of current assets of $2 460 million; investments of $291 million; property, plant and equipment of $6 030 million and deferred charges of $65 million.

Deductions from the consolidated assets for liabilities, deferred income taxes and preferred shares issued by a subsidiary resulted in net assets of $3 642 million.

Management's Responsibility for the Financial Statements

The financial statements have been prepared by management in accordance with generally accepted accounting principles appropriate in the circumstances. Management is responsible for the other information in the Annual Report, which is consistent, where applicable, with that contained in the financial statements. Management is also responsible for installing and maintaining a system of internal control to provide reasonable assurance that reliable financial information is produced. The Corporation has an internal audit department whose functions include reviewing the systems of internal control to ensure that they are adequate and functioning properly.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, a majority of which is composed of directors who are not employees of the Corporation.

The Committee meets with management, the internal auditors and the external auditors to satisfy itself that responsibilities are properly discharged and to review the financial statements.

The external auditors conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their examination includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board.

Auditors' Report

To the Honourable Pat Carney, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Canada

We have examined the consolidated balance sheet of Petro-Canada as at December 31, 1985 and the consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change in the method of accounting for investment tax credits as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

We further report that, in our opinion, the transactions of the Corporation and its consolidated wholly-owned subsidiaries that have come to our notice in the course of our examination of the consolidated financial statements of Petro-Canada were, in all significant respects, in accordance with the Financial Administration Act and the regulations thereto, the charter and by-laws of the Corporation and its consolidated wholly-owned subsidiaries and any directives given to the Corporation.

Peat, Marwick, Mitchell & Co.
Chartered Accountants

Arthur Andersen & Co
Chartered Accountants

Calgary, Alberta
February 20, 1986

Petro-Canada

Consolidated Balance Sheet

As at December 31, 1985

(stated in thousands of dollars)

Assets	1985	1984 (Restated)
Current Assets		
Cash and short-term deposits	$ –	$ 32 819
Accounts receivable	1 307 339	836 854
Inventories (Note 4)	1 109 451	845 715
Income taxes recoverable	10 413	23 036
Deposits and prepaid expenses	33 157	21 394
	2 460 360	1 759 818
Investments (Note 5)	290 843	594 234
Property, Plant and Equipment, net (Note 6)	6 030 165	6 513 940
Deferred Charges (Note 7)	64 724	98 172
	$ 8 846 092	$ 8 966 164

Approved on behalf of the Board

Director

Director

Liabilities and Shareholder's Equity

	1985	1984 (Restated)
Current Liabilities		
Outstanding cheques less cash	$ 22 344	$ –
Short-term notes payable	531 539	–
Accounts payable and accrued liabilities	1 489 160	807 913
Current portion of long-term debt	20 430	47 102
	2 063 473	855 015
Long-Term Liabilities	197 516	–
Long-Term Debt (Note 8)	269 131	109 947
Advances on Future Natural Gas Deliveries	145 488	173 436
Minority Interest in Subsidiaries	–	419 813
Deferred Income Taxes	1 303 901	1 617 372
Redeemable Preferred Shares (Note 9)	1 224 217	1 312 080
Capital (Note 10)	4 161 072	4 161 072
Contributed Surplus	–	62 461
Retained Earnings (Deficit)	(518 706)	254 968
	3 642 366	4 478 501
	$ 8 846 092	$ 8 966 164

Petro-Canada

Consolidated Statement of Earnings

For the Year Ended December 31, 1985

(stated in thousands of dollars)

	1985	1984 (Restated)
Revenue		
Operating	$ 5 300 097	$ 4 881 293
Investment and other income	80 834	107 470
	5 380 931	4 988 763
Expenses		
Crude oil and product purchases	2 901 164	2 780 170
Producing and refining	552 746	475 331
Marketing, general and administrative	552 548	403 170
Taxes other than income taxes (Note 11)	427 576	343 784
Depreciation, depletion and amortization	410 190	362 994
Interest on long-term debt	24 264	11 324
	4 868 488	4 376 773
Earnings Before Undernoted Items	512 443	611 990
Provision for Income Taxes (Note 12)		
Deferred	295 776	309 418
Current	44 887	75 501
	340 663	384 919
	171 780	227 071
Minority Interest	2 100	4 961
Earnings Before Unusual Items and Dividends on Redeemable Preferred Shares	173 880	232 032
Unusual Items (Note 13)	864 901	–
Net Earnings (Loss) for Year Before Dividends on Redeemable Preferred Shares	(691 021)	232 032
Dividends on Redeemable Preferred Shares (Note 9)	78 314	100 083
Net Earnings (Loss) for Year After Dividends on Redeemable Preferred Shares	$ (769 335)	$ 131 949

Petro-Canada

Consolidated Statement of Retained Earnings

For the Year ended December 31, 1985

(stated in thousands of dollars)

	1985	1984
Retained Earnings at Beginning of Year, as previously reported	$ 353 046	$ 212 027
Retroactive application of change in accounting policy for investment tax credits (Note 2)	(98 078)	(78 578)
Retained Earnings at Beginning of Year, as restated	254 968	133 449
Net earnings (loss) for year before dividends on redeemable preferred shares	(691 021)	232 032
Dividends – Redeemable preferred shares	(78 314)	(100 083)
– Common shares	(50 000)	–
Exchange adjustment on redemption of redeemable preferred shares	(16 800)	(10 430)
Transfer from contributed surplus	62 461	–
Retained Earnings (Deficit) at End of Year	$ (518 706)	$ 254 968

Consolidated Statement of Changes in Financial Position

For the Year Ended December 31, 1985

(stated in thousands of dollars)

	1985	1984 (Restated)
Internally Generated Cash		
Working capital provided from operations (Note 14)	$ 870 238	$ 896 136
Proceeds from sale of property, plant and equipment	63 979	51 454
Advances on future natural gas deliveries	(27 948)	20 266
Internally generated cash	906 269	967 856
Investment Activities		
Acquisition of Gulf Canada Limited assets (Note 3)	713 947	–
Expenditures on property, plant and equipment	1 059 192	1 130 965
Petroleum Incentive Program grants	(348 526)	(380 304)
Increase (decrease) in investments, net	(329 772)	282 103
(Increase) decrease in minority interest in subsidiaries	295 755	(1 859)
Increase (decrease) in operating working capital (Note 15)	(15 628)	135 480
Increase in deferred charges	3 892	14 014
	1 378 860	1 180 399
Financing Activities and Dividends		
Proceeds from issue of short-term notes payable, net	531 539	–
Proceeds from issue of long-term debt	165 275	–
Redemption of redeemable preferred shares	(104 663)	(92 435)
Dividends – Redeemable preferred shares	(78 314)	(100 083)
– Common shares	(50 000)	–
Reduction of long-term debt	(46 409)	(42 704)
Issue of common shares	–	425 000
	417 428	189 778
Decrease in Cash	55 163	22 765
Cash and Short-Term Deposits at Beginning of Year	32 819	55 584
Cash and Short-Term Deposits (Deficiency) at End of Year	$ (22 344)	$ 32 819

Notes to Consolidated Financial Statements

December 31, 1985

(tabular amounts shown in thousands of dollars)

1. Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada, an agent of Her Majesty in the right of Canada, and of all subsidiary companies ("the Corporation") except Canertech Inc., which is excluded for the reason described in Note 5.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition is attributed to the related assets acquired and is amortized over the life of these assets.

(b) Inventories

Inventories are valued at the lower of cost and net realizable value.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity method. Other long-term investments are accounted for on the cost method.

(d) Property, Plant and Equipment

The Corporation accounts for its investment in oil and gas properties on the full cost method whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, drilling both productive and non-productive wells and overhead related to exploration. The Corporation applies a "ceiling test", to capitalized costs in each producing cost centre, to ensure that such costs do not exceed the estimated future net revenues from production of proven reserves, at prices and operating costs in effect at the balance sheet date, together with the estimated fair market value of unevaluated properties.

Separate cost centres have been established for non-frontier Canada, the Syncrude Project, producing in situ oil sands, other oil sands leases and each Canadian frontier area and foreign area in which the Corporation has an interest.

The interest cost of debt attributable to the construction of major new facilities is capitalized during the construction period.

Substantially all of the Corporation's exploration and production activities related to oil and gas are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

(e) Depreciation, Depletion and Amortization

Costs incurred in non-frontier Canada, the Syncrude Project, producing in situ oil sands and in producing foreign cost centres are depreciated or depleted separately on the unit of production method based on estimated proven recoverable oil and gas reserves. For purposes of calculating depreciation and depletion, natural gas production and reserves are converted to equivalent units of crude oil based on the relative energy content of each commodity.

Annual costs incurred in the other cost centres are amortized on a straight line basis over the period during which exploration activity in each cost centre is expected to continue. When exploration proves to be successful, as when an indicated commercial discovery is made, amortization is suspended and the unamortized balance of the cost centre is depleted on the unit of production method when production commences. When exploration proves to be unsuccessful and the cost centre is condemned or abandoned, the unamortized balance of that cost centre is charged to earnings at that time.

Depreciation of other plant and equipment is provided on either the unit of production method or the straight line method as appropriate. Straight line depreciation rates are based on the estimated service life of the related asset.

(f) Deferred Charges

Costs relating to the removal of overburden from oil sands which will be mined in future years are deferred and are charged to earnings when the related oil sands are mined.

(g) Federal Petroleum Compensation Program

Amounts received under the Federal Compensation Program for oil imports are deducted from the cost of crude oil and product purchases. Amounts received under the Federal Compensation Program for synthetic crude oil are included in operating revenue.

(h) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming depreciation, exploration, development and other costs for income tax purposes which differ from the related amounts charged to expense in the financial statements.

(i) Translation of Foreign Currency
Current assets, except inventories and prepaid expenses, current liabilities and long-term debt are translated at rates of exchange in effect at the balance sheet date. Long-term assets, inventories, prepaid expenses, deferred income taxes and redeemable preferred shares are translated at rates of exchange in effect at the respective transaction dates. Revenue and expense items are translated at the average rates of exchange in effect during the year, except for depreciation, depletion and amortization which reflect rates of exchange in effect when the assets were acquired.

The resulting exchange gains or losses are included in earnings, except for unrealized exchange gains or losses arising on translation of long-term debt which are deferred and amortized over the remaining term of the debt.

Foreign operations are integrated with the Corporation's other activities and are translated in the above described manner.

(j) Pension Plans
Costs of pension benefits for current services of employees are funded and are charged to earnings as they accrue. Costs arising from amendments to pension plans which relate to services of employees in prior years and experience deficiencies are funded in accordance with applicable pension legislation and charged to earnings over periods not exceeding fifteen years.

2. Change in Accounting Policy

During 1985 the Corporation changed its method of accounting for investment tax credits in accordance with the recommendations issued by the Canadian Institute of Chartered Accountants. Investment tax credits, previously recognized on a flow through basis, are now accounted for by the cost reduction method. This change has been applied retroactively and the prior year's financial statements restated.

The effect of this change in 1985 has been to increase the net loss for year after dividends on redeemable preferred shares by $13 483 000.

3. Acquisitions

(a) Gulf Canada Limited ("Gulf") Refining and Marketing Assets
Effective September 30, 1985, the Corporation acquired certain refining and marketing assets from Gulf for an initial cash consideration of $611 000 000. Additional costs, relating to the acquisition, in the amount of $102 947 000 have been accrued.

The net assets acquired, at attributed values, consist of:

Property, plant and equipment	$ 406 850
Investments	14 487
Net working capital	292 610
	$ 713 947

In addition, the Corporation has agreed to purchase the Edmonton refinery assets for an aggregate cash consideration of $275 000 000 by the earlier of February 27, 1987 or thirty days after the dissolution of a partnership which currently owns the assets.

(b) Petro-Canada Products Inc. ("Products")
Pursuant to a tender offer dated February 28, 1983 the Corporation committed to acquire all of the outstanding voting and non-voting shares of Products (formerly BP Refining and Marketing Canada Limited). During 1985 the Corporation completed its acquisition of Products by purchasing the remaining non-voting shares for a consideration, including related expenses, of $301 953 000. The aggregate cost of acquiring the shares of Products was $424 704 000.

Funds for the 1985 share purchase were provided from cash held for use in tender offer and an issue of long-term debt.

4. Inventories

Inventories consist of:

	1985	1984
Crude oil, refined products and merchandise	**$ 1 043 335**	$ 768 774
Materials and supplies	**66 116**	76 941
	$ 1 109 451	$ 845 715

5. Investments

Investments consist of:

	1985	1984
At equity		
Westcoast Transmission Company Limited	**$ 181 299**	$ 176 984
Petro-Canada Centre	**24 091**	222 505
Sedpex Inc.	**22 602**	15 334
Other	**11 839**	4 418
At cost		
Mortgages and other investments	**51 012**	43 114
Cash held for use in tender offer	**–**	131 879
Canertech Inc.	**–**	–
	$ 290 843	$ 594 234

Westcoast Transmission Company Limited ("Westcoast")
At December 31, 1985 the Corporation held 31.1% of the total outstanding common shares of Westcoast.

The cost of the investment in Westcoast exceeded the underlying net book value at the dates of acquisition. This excess is being amortized over the estimated useful lives of the underlying assets to which it is attributed by charges against the Corporation's share of Westcoast's net earnings.

Westcoast is a regulated utility and is subject to regulatory directives which may change the components of the cost of service. Changes resulting from such directives do not have a direct effect on net earnings due to rate of return on rate base considerations which are also taken into account in the regulatory process.

At December 31, 1985 the quoted market value of the Corporation's investment in Westcoast was $227 517 000 (1984 – $190 924 000).

Petro-Canada Centre
At December 31, 1985 the Corporation held 50% of a joint venture which owns Petro-Canada Centre, an office complex in Calgary. The Corporation has entered into a long-term lease for use of a portion of the complex (Note 20) and has guaranteed $286 000 000 of long-term debt related to the facility.

Sedpex Inc.
At December 31, 1985 the Corporation held 50% of the total outstanding common shares of Sedpex Inc., a company which owns a semi-submersible drilling vessel. This vessel is under lease to the Corporation (Note 20).

Canertech Inc. ("Canertech")
The accounts of Canertech, a wholly-owned subsidiary company, have been excluded from consolidation because a formal plan exists to dispose of the investment in the subsidiary. In response to a directive by the Government of Canada, the Corporation incorporated Canertech in 1981 to develop alternate energy sources. At that time the Government indicated its intention of purchasing the Corporation's investment at cost and establishing Canertech as an independent crown corporation. During 1984 the Government directed the Corporation to bring about the dissolution of Canertech. The Corporation is proceeding with the implementation of this directive. The Corporation's investment in Canertech is carried in the accounts at its original cost of $1.

6. Property, Plant and Equipment

Property, plant and equipment consists of:

	1985			1984
	Cost*	*Accumulated Depreciation, Depletion and Amortization*	*Net*	*Net*
Oil and gas				
Canada				
– non-frontier areas	**$ 3 911 728**	**$ 821 373**	**$ 3 090 355**	$ 3 068 344
– frontier areas	**1 011 122**	**795 268**	**215 854**	915 270
Foreign	**163 394**	**106 786**	**56 608**	81 133
Refining and marketing	**2 016 063**	**279 178**	**1 736 885**	1 375 598
Oil sands				
Syncrude Project	**618 542**	**92 698**	**525 844**	486 361
Producing in situ	**85 431**	**5 016**	**80 415**	–
Other oil sands	**197 541**	**197 541**	**–**	207 457
Natural gas liquids	**202 865**	**59 674**	**143 191**	128 885
Other property and equipment	**342 621**	**161 608**	**181 013**	250 892
	$ 8 549 307	**$ 2 519 142**	**$ 6 030 165**	$ 6 513 940

* Cost is net of related Petroleum Incentive Program grants and investment tax credits.

7. Deferred Charges

Deferred charges consist of:

	1985	1984
At cost		
Oil sands overburden removal costs	**$ 44 395**	$ 41 511
Less portion related to oil sands to be mined within one year	**14 032**	10 730
	30 363	30 781
Polar Gas Project	**1 534**	17 617
At amortized cost		
Translation adjustment on long-term debt	**19 884**	9 085
Marketing reidentification	**–**	28 588
Other	**12 943**	12 101
	$ 64 724	$ 98 172

8. Long-Term Debt

Long-term debt consists of:

	Maturity	1985	1984
In Canadian dollars			
8.25% unsecured notes	1993	$ 14 375	$ 14 375
5.75% unsecured notes	1986	6 961	6 961
Promissory notes, bearing interest at prime rate		–	13 192
Unsecured loans, bearing interest at prime rate to ½% above prime rate		–	9 500
Other loans and long-term obligations	1986 – 1988	1 523	1 923
In United States dollars			
LIBOR less 0.8% unsecured notes ($125 000 000 U.S.)	1995	174 688	–
9% unsecured notes ($41 250 000 U.S.)	1996	57 646	59 466
7.75% unsecured notes ($14 000 000 U.S.)	1993	19 565	21 142
8.45% unsecured notes ($10 000 000 U.S.)	1987	13 975	19 821
5.75% – 6.25% mortgages ($592 000 U.S.)	1988	828	2 080
5.25% unsecured notes		–	8 589
		289 561	157 049
Less current portion		20 430	47 102
		$ 269 131	$ 109 947

Repayment of long-term debt

The minimum repayment of long-term debt in each of the next five years is as follows:

1986 – $ 20 430 000
1987 – $ 13 894 000
1988 – $ 7 700 000
1989 – $ 7 698 000
1990 – $ 7 695 000

9. Redeemable Preferred Shares

The redeemable preferred shares, which were issued by a subsidiary to a group of Canadian chartered banks, are floating rate, cumulative, redeemable and non-voting. Cumulative dividends, payable quarterly, are, at the option of the subsidiary, based on a percentage of either the United States Base Rates or the London Inter-Bank Offered Rates of the banks. At December 31, 1985, the dividend rate was approximately 4.6% per annum. The shares are redeemable, at the option of the subsidiary, at $100 U.S. per share, plus accrued dividends. In 1985 the subsidiary exercised its option to redeem 750 000 shares (1984 – 700 000 shares) for a consideration of $75 000 000 U.S. (1984 – $70 000 000 U.S.) and 10 450 000 shares were outstanding at December 31, 1985.

Under the terms of an agreement between the banks and the Corporation, in the event that the subsidiary does not exercise its option to redeem the shares over an eight year period ending December 31, 1993, or in the event of certain other occurrences under the provisions of the agreement, the banks have the option to require the Corporation to purchase the shares at $100 U.S. per share, plus accrued dividends. These annual options increase from $85 000 000 U.S. to $170 000 000 U.S. over the remaining period.

10. Capital

Authorized

In the aggregate the authorized capital is:
(a) 71 188 common shares with a par value of $100 000 each.
(b) Preferred shares issued to the Government of Canada provided that the amount of such shares together with any loans received, and outstanding, from the Consolidated Revenue Fund of the Government of Canada is not in excess of $1 billion.

Issued (to the Government of Canada)

	1985		1984	
	Number of Shares	*Consideration*	*Number of Shares*	*Consideration*
Common Shares				
Balance at beginning of year	**31 883**	**$ 3 188 300**	27 633	$ 2 763 300
For cash	–	–	4 250	425 000
Balance at end of year	**31 883**	**3 188 300**	31 883	3 188 300
Preferred Shares				
Balance at beginning and end of year	**972 771 853**	**972 772**	972 771 853	972 772
Total Capital at End of Year		**$ 4 161 072**		$ 4 161 072

The preferred shares have a par value of $1 each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

11. Taxes Other than Income Taxes

Taxes other than income taxes consist of:

	1985	1984
Federal sales tax	**$ 249 341**	$ 184 508
Petroleum and Gas Revenue Tax	**123 448**	118 536
Other	**54 787**	40 740
	$ 427 576	$ 343 784

12. Income Taxes

The provision for income taxes of $340 663 000 (1984 – $384 919 000) represents an effective rate of 66.5% (1984 – 62.9%) on earnings before income taxes of $512 443 000 (1984 – $611 990 000). The computation of the provision, which requires adjustment to earnings before income taxes for non-taxable and non-allowable items, is as follows:

	1985	1984
Earnings before income taxes	$ 512 443	$ 611 990
Add (deduct)		
Royalties and other payments to provincial governments	307 096	327 560
Federal allowances		
Resource allowance	(259 999)	(245 909)
Tax depletion	(21 046)	(29 268)
Inventory allowance	(29 556)	(10 498)
Petroleum and Gas Revenue Tax	123 448	118 536
Non-deductible depreciation, depletion and amortization	95 442	98 661
Equity in earnings of affiliates	(22 383)	(17 874)
Foreign exchange gains	(2 781)	(4 846)
Other	5 805	291
Earnings as adjusted before income taxes	$ 708 469	$ 848 643
Canadian Federal income tax at 46.9% (1984 – 46%) applied to earnings as adjusted	$ 332 272	$ 390 375
Provincial and other income taxes, net of federal abatement	16 215	3 624
Provincial income tax rebate plans	(7 824)	(9 080)
Provision for income taxes	$ 340 663	$ 384 919

13. Unusual Items

The unusual items charged to earnings during 1985 consist of:

Canada frontier oil and gas properties	$ 547 614
Process development costs	108 168
Oil sands properties	90 153
Inventory adjustment	45 354
Relocation and reorganization	20 231
Foreign oil and gas properties	16 715
Coal and mineral properties	14 806
Marketing reidentification	13 096
Polar Gas Project	8 764
	$ 864 901

Canada frontier oil and gas properties
As a result of the decline in world oil prices and changes in the current and anticipated energy environment, the Corporation has written off the carrying value of certain of its Canadian frontier oil and gas properties. Accordingly, the unamortized costs of these properties together with provisions for anticipated losses on contracted offshore drilling vessels and ancillary equipment, amounting to $547 614 000 (after deducting related income taxes of $443 081 000 and minority interest of $121 958 000), have been charged to earnings.

Process development costs
Construction of a plant to demonstrate a process for upgrading heavy residual fuel oils was completed during 1985. This plant was constructed pursuant to a directive by the Government of Canada. As a result of changed economic conditions the Corporation has charged the project costs, amounting to $108 168 000 (after deducting related income taxes of $37 080 000), to earnings.

Oil sands properties
As a result of the decline in world oil prices and uncertainties as to the timing of new oil sands developments, the Corporation has written off the carrying value of its oil sands properties other than the producing in situ and Syncrude projects. Accordingly, the unamortized costs of these properties, amounting to $90 153 000 (after deducting related income taxes of $49 212 000), have been charged to earnings.

Inventory adjustment
As a result of the Western Accord the Corporation is no longer required to sell its Alberta crude oil production to the Alberta Petroleum Marketing Commission and since June 1, 1985 it has supplied crude oil directly to its own refineries. This change extends the point of sale and the resultant profit recognition from the wellhead to the refined product customer. At December 31, 1985 inventory has been reduced by $45 354 000 (after deducting related income taxes of $30 680 000) and this amount has been charged to earnings.

Relocation and reorganization
During 1985 the Corporation announced plans to relocate certain functions relating to its refining and marketing operations from Eastern Canada to Calgary. In addition, the Corporation commenced an internal reorganization program which will result in a staff reduction. The estimated costs associated with the relocation and reorganization in the amount of $20 231 000 (after deducting related income taxes of $18 869 000) have been charged to earnings.

Foreign oil and gas properties
The Corporation has written off the carrying value of its China cost centre because of a lack of exploration success. Accordingly, $16 715 000 (after deducting related income taxes of $15 043 000) has been charged to earnings.

Coal and mineral properties
As a result of the decline in world prices and uncertainties as to the timing of the development of coal and mineral properties, the Corporation has written off the carrying value of these properties. Accordingly, the remaining cost of these properties, amounting to $14 806 000 (after deducting related income taxes of $13 296 000), has been charged to earnings.

Marketing reidentification
The Corporation has determined that it has realized substantially all of the economic benefits of marketing reidentification costs incurred in prior years, which were deferred and amortized over the period during which benefits were expected to be realized. Accordingly, the unamortized balance of these costs, amounting to $13 096 000 (after deducting related income taxes of $12 045 000), has been charged to earnings.

Polar Gas Project
The Polar Gas Project has recently completed its application to the National Energy Board to build a pipeline from the Mackenzie Delta to Edson, Alberta and has abandoned its plans for a pipeline from the Arctic Islands to Eastern Canada. Costs incurred in prior years, relating to feasibility studies in connection with the abandoned route, which were deferred, amounting to $8 764 000 (after deducting related income taxes of $8 171 000), have been charged to earnings.

14. Working Capital Provided from Operations

Working capital provided from operations consists of:

	1985	1984
Earnings before unusual items and dividends on redeemable preferred shares	$ 173 880	$ 232 032
Add (deduct):		
Depreciation, depletion and amortization	410 190	362 994
Deferred income taxes	295 776	309 418
Equity earnings, net of dividends received	(6 594)	(2 640)
Other	(3 014)	(5 668)
	$ 870 238	$ 896 136

15. Change in Components of Operating Working Capital

The increase (decrease) in operating working capital consists of the following movements during the year:

	1985	1984
Accounts receivable	$ 470 485	$ 17 662
Inventories	263 736	134 709
Income taxes recoverable	(12 623)	(4 229)
Deposits and prepaid expenses	11 763	2 720
Accounts payable and accrued liabilities	(681 247)	(15 382)
Operating working capital acquired from Gulf Canada Limited (Note 3)	(292 610)	–
Current accruals relating to unusual items (Note 13), and other	224 868	–
	$ (15 628)	$ 135 480

Operating working capital is comprised of working capital other than cash and short-term deposits, short-term notes payable and current portion of long-term debt.

16. Pension Plans

Based on the most recent actuarial valuations of the Corporation's pension plans the unfunded past service pension obligations at December 31, 1985 are approximately $67 000 000. All accrued, including vested, benefits at December 31, 1985 are fully funded.

17. Material Transactions with Related Parties

The Corporation has transactions with the Government of Canada and its agencies which are in the normal course of business and are therefore on the same terms as those accorded to non-related parties.

18. Segmented Information

The Corporation operates principally in the following business segments:

Business Segment	*Operations*
Natural resources	Exploration, development and production activities for crude oil, natural gas, field liquids, sulphur, oil sands; extraction of liquids from natural gas; transportation, distribution and marketing of the natural gas liquids.
Refined oil products	Purchase and sale of crude oil; refining crude oil into oil products; distribution and marketing of these and other purchased refined oil products.

The financial results of operations by business segment are as follows:

	Natural Resources		*Refined Oil Products*		*Eliminations*		*Total*	
	1985	1984	**1985**	1984	**1985**	1984	**1985**	1984
Sales to customers	**$ 971 526**	$ 1 450 252	**$ 4 328 571**	$ 3 431 041	**$ –**	$ –	**$ 5 300 097**	$ 4 881 293
Inter-segment transfers	**660 507**	88 572	**–**	–	**(660 507)**	(88 572)	**–**	–
Total Operating Revenue	**1 632 033**	1 538 824	**4 328 571**	3 431 041	**(660 507)**	(88 572)	**5 300 097**	4 881 293
Product costs and operating expenses	**533 559**	534 472	**3 580 858**	2 809 601	**(660 507)**	(88 572)	**3 453 910**	3 255 501
Depreciation, depletion and amortization	**282 979**	250 727	**97 327**	84 833	**–**	–	**380 306**	335 560
Taxes other than income taxes	**147 795**	121 688	**279 781**	222 096	**–**	–	**427 576**	343 784
	964 333	906 887	**3 957 966**	3 116 530	**(660 507)**	(88 572)	**4 261 792**	3 934 845
Operating Earnings	**$ 667 700**	$ 631 937	**$ 370 605**	$ 314 511			**1 038 305**	946 448
Marketing, general and administrative expenses							**(552 548)**	(403 170)
Provision for income taxes							**(340 663)**	(384 919)
Investment and other income							**80 834**	107 470
Other depreciation and amortization							**(29 884)**	(27 434)
Interest on long-term debt							**(24 264)**	(11 324)
Minority interest							**2 100**	4 961
							(864 425)	(714 416)
Earnings Before Unusual Items and Dividends on Redeemable Preferred Shares							**$ 173 880**	$ 232 032

Inter-segment transfers are accounted for at market value.

Natural resources segment revenue consists of:

	1985	1984
Crude oil and field liquids	**$ 990 178**	$ 867 366
Natural gas liquids	**301 532**	325 058
Natural gas	**291 962**	284 522
Other	**48 361**	61 878
	$ 1 632 033	$ 1 538 824

Refined oil products segment revenue consists of:

	1985	1984
Gasoline	**$ 2 231 710**	$ 1 813 981
Distillates	**1 349 573**	1 025 140
Other	**747 288**	591 920
	$ 4 328 571	$ 3 431 041

The identifiable assets at December 31, and the capital expenditures for the year, by business segment, are as follows:

	Identifiable Assets		*Capital Expenditures**	
	1985	1984	**1985**	1984
Natural resources	**$ 4 509 488**	$ 5 444 759	**$ 869 341**	$ 954 217
Refined oil products	**3 808 278**	2 634 699	**168 127**	136 400
Other	**528 326**	886 706	**(172 277)**	204 586
	$ 8 846 092	$ 8 966 164	**$ 865 191**	$ 1 295 203

Other identifiable assets include cash and short-term deposits, investments in other companies and general corporate assets.

* Capital expenditures are before deduction of related Petroleum Incentive Program grants.

19. Comparative Figures

Certain reclassifications have been made to the 1984 comparative figures to conform with the current year's presentation.

20. Commitments and Contingencies

(a) Commitments

The Corporation has leased certain offshore drilling vessels and ancillary equipment under various contracts, the last of which expires in 1988. The rentals for these offshore vessels, when used by the Corporation, are shared with joint venture participants. The vessels are available for sublease when not required by the Corporation.

The gross lease rentals for the offshore vessels, less accrued amounts relating to the unusual items (Note 13), together with minimum annual rentals for Petro-Canada Centre (Note 5) and other non-cancellable operating leases are estimated at $95 000 000 in 1986, $63 000 000 in 1987, $45 000 000 in 1988, $44 000 000 in 1989, $41 000 000 in 1990 and $15 000 000 per year thereafter until 2008.

(b) Contingencies

The Corporation is involved in litigation and claims associated with normal operations. Management is of the opinion that any resulting settlements would not materially affect the financial position of the Corporation.

Supplementary Financial Information Reporting the Effects of Changing Prices (Unaudited)

December 31, 1985

Basis of Presentation

Petro-Canada's financial statements report financial information on the basis of historical cost in accordance with generally accepted accounting principles. Although the rate of inflation declined substantially in recent years, historically the economy has experienced significant inflationary increases and many of the effects of such increases are not reflected in the traditional financial statements. The additional costs required to replace current inventories and property, plant and equipment, and the effects of holding net monetary liabilities or assets are not reflected in the historical cost financial statements. The Canadian Institute of Chartered Accountants (CICA) has issued recommendations relating to the preparation of information reporting the effects of changing prices. These recommendations are considered experimental by the CICA. The intent is to determine if this information is helpful to the users of financial information in their assessment of an enterprise. The following information has been prepared based upon the CICA recommendations, except for the computation of the provision for income taxes which is addressed below.

While Petro-Canada has prepared this information using what are considered to be reasonable assumptions it should be noted that the recommendations call for a degree of subjective judgement and materially different results could be obtained if other equally valid assumptions were used. Additionally, the recommendations recognize that the cost of exploration and development required to replace oil and gas reserves is subject to a high degree of uncertainty. Despite this the recommendations call for the estimating of the current cost of oil and gas reserves and suggest the use of indices. Petro-Canada has followed this approach but cautions that these current cost estimates may be misleading and do not necessarily represent amounts for which the reserves could be bought or costs which would be incurred in future periods if the reserves were replaced.

Explanation of Information

The schedule of Balance Sheet Items on a Current Cost Basis reports the current cost of inventory and property, plant and equipment and the effect of the current cost adjustments on net assets. The current cost of property, plant and equipment has been calculated through the use of indices. Net assets represents the historical common shareholder's equity adjusted for the current cost adjustments.

The Consolidated Statement of Earnings on a Current Cost Basis presents a comparison of the Corporation's statement of earnings as presented in the historical cost financial statements with similar data prepared on a current cost basis. Equity earnings have been adjusted to reflect Petro-Canada's share of affiliates' current cost adjustments. Crude oil and product purchases expense has been adjusted to reflect the current cost of these purchases at the time of use. Depreciation expense has been adjusted so that it reflects the estimated current cost of replacing the operating capacity of property, plant and equipment. The CICA recommends that the amount of income tax in the computation of earnings on the current cost basis be the same as the amount charged against earnings in the historical cost financial statements. However, the Corporation believes that it is more appropriate to adjust the provision for deferred income taxes in recognition of the lower cost of sales and higher depreciation, depletion and amortization expense. Since this unaudited supplementary information is experimental, these adjustments have been reflected in the computation of deferred income taxes in the Consolidated Statement of Earnings on a Current Cost Basis. Had the Corporation followed the CICA recommendations with regard to income tax expense in the computation of current cost earnings, the provision for deferred income taxes would have been $295 776 000. It should be noted that there is no deduction under current tax law for these current cost adjustments. Minority interest has been adjusted to reflect its share of the current cost depreciation, depletion and amortization expense adjustment.

The schedule of Other Supplementary Current Cost Information presents the remaining financial information required by the recommendations. The financing adjustment represents the portion of current cost adjustments that relate to the net monetary liabilities of Petro-Canada. The CICA has defined this as "the amount of changes during a reporting period in the current cost of assets held by an

enterprise that, on the basis of the existing relationship between debt and equity, do not need to be charged against present and future revenues to provide for maintenance of the common shareholders' proportionate interest in the operating capability of the enterprise". The second portion of the schedule isolates the inflation component from the total increase in the current cost of property, plant and equipment and inventory. The final information presented is the gain in general purchasing power that results from having net monetary liabilities. This arises because inflation erodes the purchasing power of money and therefore where there are net monetary liabilities a "gain" is recognized due to the net monetary liabilities requiring the use of less "purchasing power" over time during inflationary periods.

The CICA recommendations also require the disclosure of oil and gas reserve data, net of royalties. The schedule of Supplementary Reserve Information provides this information.

Balance Sheet Items on a Current Cost Basis

December 31, 1985

(stated in thousands of dollars)

	As reported in the historical cost statements	*Current cost basis*
Inventory	$ 1 109 451	$ 1 104 957
Property, plant and equipment, net	$ 6 030 165	$ 8 201 801
Net assets (shareholder's equity)	$ 3 642 366	$ 5 809 508

Consolidated Statement of Earnings on a Current Cost Basis

For the Year Ended December 31, 1985

(stated in thousands of dollars)

	As reported in the historical cost statements	*Current cost basis*
Revenue		
Operating	$ 5 300 097	$ 5 300 097
Investment and other income	80 834	77 246
	5 380 931	5 377 343
Expenses		
Crude oil and product purchases	2 901 164	2 854 507
Producing and refining	552 746	552 746
Marketing, general and administrative	552 548	552 548
Taxes other than income taxes	427 576	427 576
Depreciation, depletion and amortization	410 190	548 468
Interest on long-term debt	24 264	24 264
	4 868 488	4 960 109
Earnings before Undernoted Items	512 443	417 234
Provision for Income Taxes		
Deferred	295 776	275 042
Current	44 887	44 887
	340 663	319 929
	171 780	97 305
Minority Interest	2 100	2 919
Earnings before Unusual Items and Dividends on Redeemable Preferred Shares	$ 173 880	$ 100 224

Other Supplementary Cost Information

For the Year Ended December 31, 1985

(stated in thousands of dollars)

1) Financing adjustment	
Based on the amount of changes during the year in the current cost amounts of property, plant and equipment and inventory	$ 81 340
Based on the current cost adjustments made to net earnings during the year	$ 23 127
2) Increase in the current cost amount of property, plant and equipment and inventory	$ 322 393
Effect of general inflation	404 833
Excess of general inflation over the increase in current cost	$ 82 440
3) Gain in general purchasing power from having net monetary liabilities	$ 86 382

Supplementary Reserve Information

December 31, 1985

	Oil	Natural Gas Liquids	Gas
	(Thousands of cubic metres)	*(Thousands of cubic metres)*	*(Millions of cubic metres)*
Proven reserves, net after royalties at December 31, 1984	35 367.0	4 686.0	100 416.4
Revisions of previous estimates	1 672.1	1 277.1	(20 414.2)
Extensions and discoveries	567.3	—	1 185.7
Production	(2 892.5)	(469.6)	(3 325.9)
Proven reserves, net after royalties at December 31, 1985	34 713.9	5 493.5	77 862.0

The above figures do not include Petro-Canada's 17% interest in the synthetic crude oil reserves of Syncrude Canada Limited ("Syncrude") (39 102.0 thousand cubic metres before royalty at December 31, 1985). Pursuant to an agreement between the Province of Alberta as lessor of the oil sands leases and the Syncrude participants the Province has the right to 50% of Syncrude's deemed net profits, as defined in the agreement. At the Province's option, this right may, in accordance with the provisions of the agreement, be converted to a 7.5% gross production royalty. Both the 50% of deemed net profits and the 7.5% gross production royalty are subject to change under certain circumstances. In view of these potential changes, and the attendant uncertainties relating to future prices and costs, the Corporation has not presented its synthetic crude oil reserves net of royalties.

Five Year Operating Summary

	1985	1984	1983	1982	1981
Oil and Gas Landholdings (Gross/Net)					
(millions of hectares)					
Non-frontier areas					
Conventional	**4.4/2.1**	4.8/2.4	6.0/3.1	6.4/3.3	6.5/3.5
Oil Sands	**1.0/0.4**	0.9/0.3	0.9/0.3	0.8/0.3	0.8/0.3
	5.4/2.5	5.7/2.7	6.9/3.4	7.2/3.6	7.3/3.8
Frontiers	**33.2/16.5**	41.6/20.5	54.4/25.0	55.7/25.6	57.3/28.7
International	**3.4/1.1**	2.8/0.4	1.7/0.1	0.6/0.1	0.6/0.1
Total oil and gas landholdings	**42.0/20.1**	50.1/23.6	63.0/28.5	63.5/29.3	65.2/32.6
Wells Drilled (Gross/Net)					
Non-frontier areas – exploratory wells					
Oil	**52/37**	65/45	41/30	52/32	46/25
Gas	**51/26**	25/11	24/16	28/15	54/23
Dry	**63/44**	74/47	68/48	48/36	72/35
	166/107	164/103	133/94	128/83	172/83
Non-frontier areas – development wells					
Oil	**474/166**	344/134	148/84	129/68	73/39
Gas	**44/25**	16/6	17/12	138/86	100/53
Oil Sands	**0/0**	193/96	27/13	0/0	0/0
Dry	**47/22**	24/10	9/5	49/31	20/11
	565/213	577/246	201/114	316/185	193/103
Frontiers and international – exploratory and development wells					
Oil	**16/4**	9/2	5/1	7/1	7/1
Gas	**10/4**	9/2	6/2	3/1	4/1
Dry	**26/7**	25/8	14/5	7/1	6/1
	52/15	43/12	25/8	17/3	17/3
Total wells drilled	**783/335**	784/361	359/216	461/271	382/189
Proven Reserves (Net Before Royalties) (Note 3)					
Natural gas (billions of m³)	**98.8**	120.4	134.3	135.8	138.3
Crude oil (millions of m³)	**45.3**	48.4	45.0	47.1	47.0
Natural gas liquids (millions of m³)	**7.4**	6.4	7.4	7.7	8.2
Synthetic crude oil (millions of m³)	**39.1**	25.4	26.3	27.4	28.3
Foreign crude oil (millions of m³)	**0.5**	0.8	0.9	0.9	1.1
Total crude oil and natural gas liquids (millions of m³)	**92.3**	81.0	79.6	83.1	84.6

	1985	1984	1983	1982	1981
Daily Production (Net Before Royalties)					
Natural gas (millions of m^3)	**11.6**	10.8	10.0	10.6	10.7
Crude oil (thousands of m^3)	**10.0**	10.3	9.3	9.3	9.8
Natural gas liquids (thousands of m^3)	**1.8**	1.5	1.5	1.5	1.5
Natural gas liquids from straddle plants (thousands of m^3)	**2.6**	2.6	2.5	2.7	2.6
Synthetic crude oil (thousands of m^3)	**3.5**	2.3	3.0	2.3	2.1
Foreign crude oil (thousands of m^3)	**0.4**	0.4	0.5	0.2	0.2
Total crude oil and natural gas liquids (thousands of m^3)	**18.3**	17.1	16.8	16.0	16.2
Refining					
Refinery crude capacity (thousands of m^3 per day)	**46**	32	32	19	15
Refinery runs (thousands of m^3 per day)	**34**	28	25	17	13
Refinery utilization (per cent)	**78**	86	78	86	87
Marketing					
Wholesale and retail marketing outlets	**4 534**	2 716	3 107	1 605	1 504
Petroleum product sales (thousands of m^3 per day)					
Gasoline	**16.3**	13.9	12.9	7.3	5.6
Distillates	**12.2**	9.6	8.7	5.1	3.5
Other including petrochemicals	**7.0**	6.3	5.5	2.9	1.8
Total petroleum product sales	**35.5**	29.8	27.1	15.3	10.9
Employees					
Number at year end	**10 565**	6 697	6 601	6 166	5 801

Notes
1. Certain reclassifications have been made to the figures previously reported for earlier years to reflect subsequent changes in reporting presentation.
2. Operating results are included from May 12, 1981, for the former Petrofina Canada Inc. operations, from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, and from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited. Operating results for Panarctic Oils Ltd. have not been included.
3. Proven reserves do not include any reserves associated with frontier discoveries in Northern Canada and the East Coast offshore.

Five Year Financial Summary

(stated in thousands of dollars)

	1985	1984	1983	1982	1981
Summary of Earnings					
Revenue	**$ 5 380 931**	$ 4 988 763	$ 4 170 598	$ 2 788 136	$ 2 036 632
Expenses	**4 868 488**	4 376 773	3 796 721	2 477 825	1 604 288
	512 443	611 990	373 877	310 311	432 344
Add (deduct):					
Provision for income taxes	**(340 663)**	(384 919)	(267 756)	(210 693)	(263 568)
Gain on sale of subsidiary	–	–	–	7 082	–
Minority interest	**2 100**	4 961	5 823	4 735	–
Net earnings before unusual and extraordinary items and dividends on redeemable preferred shares	**173 880**	232 032	111 944	111 435	168 776
Unusual items	**864 901**	–	–	–	–
Extraordinary items	–	–	16 515	–	–
Net earnings (loss) before dividends on redeemable preferred shares	**(691 021)**	232 032	95 429	111 435	168 776
Dividends on redeemable preferred shares	**78 314**	100 083	86 379	120 082	138 971
Net earnings (loss) after dividends on redeemable preferred shares	**$ (769 335)**	$ 131 949	$ 9 050	$ (8 647)	$ 29 805
Other Financial Data					
Internally generated cash	**$ 906 269**	$ 967 856	$ 708 229	$ 586 461	$ 531 911
Expenditures on property, plant and equipment	**1 059 192**	1 130 965	996 529	952 381	559 036
Petroleum Incentive Program Grants	**348 526**	380 304	468 488	299 892	138 764
Total assets	**8 846 092**	8 966 164	8 194 001	7 541 934	6 606 185
Working capital	**396 887**	904 803	808 938	840 840	717 203
Long-term debt (Note 3)	**289 561**	157 049	188 408	330 686	1 312 773
Redeemable preferred shares	**1 224 217**	1 312 080	1 394 085	1 464 375	1 464 375
Shareholder's equity	**3 642 366**	4 478 501	3 931 982	3 284 389	1 602 192

Notes

1. Financial and operating results are included from May 12, 1981, for the former Petrofina Canada Inc. operations, from May 1, 1982, for the operations of Panarctic Oils Ltd., from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, and from October 1, 1985 for the operations of the assets acquired from Gulf Canada Limited.
2. Certain information for the years 1981-1984 has been restated to reflect the Corporation's change in accounting for investment tax credits as described in Note 2 to the consolidated financial statements. In addition, certain reclassifications have been made to the figures previously reported for earlier years to reflect subsequent changes in reporting presentation.
3. Long-term debt includes current maturities.

Design: Gottschalk + Ash Int'l, Montreal
Principal photography: Ottmar Bierwagen and Alain Cornu
Printing: Lawson Graphics Western

Sommaire des résultats des cinq derniers exercices

(en milliers de dollars)

	1985	1984	1983	1982	1981
Sommaire des résultats					
Produits	**5 380 931 $**	4 988 763 $	4 170 598 $	2 788 136 $	2 036 632 $
Charges	**4 868 488**	4 376 773	3 796 721	2 477 825	1 604 288
	512 443	611 990	373 877	310 311	432 344
Ajouter (déduire):					
Provision pour impôts sur le revenu	**(340 663)**	(384 919)	(267 756)	(210 693)	(263 568)
Gain à la vente d'une filiale	**–**	–	–	7 082	–
Participation minoritaire	**2 100**	4 961	5 823	4 735	–
Bénéfice net avant postes inhabituels et extraordinaires et dividendes des actions privilégiées rachetables	**173 880**	232 032	111 944	111 435	168 776
Postes inhabituels	**864 901**	–	–	–	–
Postes extraordinaires	**–**	–	16 515	–	–
Bénéfice net (perte) avant dividendes sur les actions privilégiées rachetables	**(691 021)**	232 032	95 429	111 435	168 776
Dividendes des actions privilégiées rachetables	**78 314**	100 083	86 379	120 082	138 971
Bénéfice net (perte) après dividendes des actions privilégiées rachetables	**(769 335)$**	131 949 $	9 050 $	(8 647)$	29 805 $
Autres données financières					
Fonds autogénérés	**906 269 $**	967 856 $	708 229 $	586 461 $	531 911 $
Dépenses affectées aux immobilisations (immeubles, usine et matériel)	**1 059 192**	1 130 965	996 529	952 381	559 036
Subventions – Programme d'encouragement pétrolier	**348 526**	380 304	468 488	299 892	138 764
Actif total	**8 846 092**	8 966 164	8 194 001	7 541 934	6 606 185
Fonds de roulement	**396 887**	904 803	808 938	840 840	717 203
Dette à long terme (note 3)	**289 561**	157 049	188 408	330 686	1 312 773
Actions privilégiées rachetables	**1 224 217**	1 312 080	1 394 085	1 464 375	1 464 375
Avoir de l'actionnaire	**3 642 366**	4 478 501	3 931 982	3 284 389	1 602 192

Notes:

1. Ces chiffres comprennent les résultats d'exploitation de la société anciennement appelée Petrofina Canada Inc., à partir du 12 mai 1981, des résultats d'exploitation de la société Panarctic Oils Ltd., à compter du 1er mai 1982, des résultats d'exploitation de la société anciennement appelée Raffinage et Marketing BP Canada Limitée, à partir du 1er mars 1983 ainsi que des résultats d'exploitation des éléments d'actif acquis de Gulf Canada Limitée depuis le 1er octobre 1985.
2. Certains renseignements pour les exercices 1981 à 1984 ont été reformulés pour tenir compte de la modification adoptée par la Société pour la comptabilisation des crédits d'impôt à l'investissement, conformément aux explications de la note 2 des états financiers consolidés. De plus, certains chiffres comptabilisés pour les exercices précédents ont été reclassés afin de tenir compte des modifications apportées à la présentation financière ultérieurement.
3. La dette à long terme comprend la tranche échéant à court terme.

Conception: Gottschalk + Ash Int'l, Montréal
Photographies principales: Ottmar Bierwagen et Alain Cornu
Impression: Lawson Graphics Western Limitée

	1985	1984	1983	1982	1981
Production journalière (nette, avant redevances)					
Gaz naturel (millions de m³)	**11,6**	10,8	10,0	10,6	10,7
Pétrole brut (milliers de m³)	**10,0**	10,3	9,3	9,3	9,8
Liquides de gaz naturel (milliers de m³)	**1,8**	1,5	1,5	1,5	1,5
Liquides de gaz naturel dans les usines de récupération (milliers de m³)	**2,6**	2,6	2,5	2,7	2,6
Pétrole brut synthétique (milliers de m³)	**3,5**	2,3	3,0	2,3	2,1
Pétrole brut étranger (milliers de m³)	**0,4**	0,4	0,5	0,2	0,2
Total du pétrole brut et des liquides de gaz naturel (milliers de m³)	**18,3**	17,1	16,8	16,0	16,2
Raffinage					
Capacité de traitement du brut (milliers de m³ par jour)	**46**	32	32	19	15
Quantités traitées (milliers de m³ par jour)	**34**	28	25	17	13
Utilisation des raffineries (pour cent)	**78**	86	78	86	87
Marketing					
Établissements de ventes en gros et au détail	**4 534**	2 716	3 107	1 605	1 504
Ventes de produits pétroliers (milliers de m³ par jour)					
Essence	**16,3**	13,9	12,9	7,3	5,6
Distillats	**12,2**	9,6	8,7	5,1	3,5
Divers, dont les produits pétrochimiques	**7,0**	6,3	5,5	2,9	1,8
Total des ventes de produits pétroliers	**35,5**	29,8	27,1	15,3	10,9
Personnel					
Nombre d'employés à la clôture	**10 565**	6 697	6 601	6 166	5 801

Notes:

1. Certains chiffres comptabilisés au cours d'exercices antérieurs ont été reclassés afin de tenir compte des modifications apportées à la présentation financière ultérieurement.
2. Ces chiffres comprennent les résultats d'exploitation de la société anciennement appelée Petrofina Canada Inc., à partir du 12 mai 1981, les résultats d'exploitation de la société antérieurement appelée Raffinage et Marketing BP Canada Limitée, à compter du 1er mars 1983, ainsi que des résultats d'exploitation des éléments d'actif acquis de Gulf Canada Limitée depuis le 1er octobre 1985. Les résultats d'exploitation de Panarctic Oils Ltd. n'ont pas été pris en compte.
3. Les réserves prouvées n'incluent aucune réserve relative aux découvertes faites dans les régions éloignées du nord du Canada et au large de la côte Est.

Exploitation – Sommaire des cinq derniers exercices

	1985	1984	1983	1982	1981
Concessions pétrolières et gazières (brutes/nettes)					
(millions d'hectares)					
Régions non éloignées					
Pétrole classique	**4,4/2,1**	4,8/2,4	6,0/3,1	6,4/3,3	6,5/3,5
Sables pétrolifères	**1,0/0,4**	0,9/0,3	0,9/0,3	0,8/0,3	0,8/0,3
	5,4/2,5	5,7/2,7	6,9/3,4	7,2/3,6	7,3/3,8
Régions éloignées	**33,2/16,5**	41,6/20,5	54,4/25,0	55,7/25,6	57,3/28,7
À l'étranger	**3,4/1,1**	2,8/0,4	1,7/0,1	0,6/0,1	0,6/0,1
Total des concessions pétrolières et gazières	**42,0/20,1**	50,1/23,6	63,0/28,5	63,5/29,3	65,2/32,6
Puits forés (bruts/nets)					
Régions non éloignées – Puits d'exploration					
Pétrole	**52/37**	65/45	41/30	52/32	46/25
Gaz	**51/26**	25/11	24/16	28/15	54/23
Stériles	**63/44**	74/47	68/48	48/36	72/35
	166/107	164/103	133/94	128/83	172/83
Régions non éloignées – Puits de mise en valeur					
Pétrole	**474/166**	344/134	148/84	129/68	73/39
Gaz	**44/25**	16/6	17/12	138/86	100/53
Sables pétrolifères	**0/0**	193/96	27/13	0/0	0/0
Stériles	**47/22**	24/10	9/5	49/31	20/11
	565/213	577/246	201/114	316/185	193/103
Régions éloignées et à l'étranger – Puits d'exploration et de mise en valeur					
Pétrole	**16/4**	9/2	5/1	7/1	7/1
Gaz	**10/4**	9/2	6/2	3/1	4/1
Stériles	**26/7**	25/8	14/5	7/1	6/1
	52/15	43/12	25/8	17/3	17/3
Total des puits forés	**783/335**	784/361	359/216	461/271	382/189
Réserves prouvées (nettes, avant redevances) (note 3)					
Gaz naturel (milliards de m³)	**98,8**	120,4	134,3	135,8	138,3
Pétrole brut (millions de m³)	**45,3**	48,4	45,0	47,1	47,0
Liquides de gaz naturel (millions de m³)	**7,4**	6,4	7,4	7,7	8,2
Pétrole brut synthétique (millions de m³)	**39,1**	25,4	26,3	27,4	28,3
Pétrole brut étranger (millions de m³)	**0,5**	0,8	0,9	0,9	1,1
Total du pétrole brut et des liquides de gaz naturel (millions de m³)	**92,3**	81,0	79,6	83,1	84,6

Autres renseignements supplémentaires au coût actuel

pour l'exercice terminé le 31 décembre 1985

(en milliers de dollars)

1) Redressement financier	
Basé sur le montant de la variation du coût actuel des immobilisations survenue au cours de l'exercice	81 340 $
Basé sur les redressements au coût actuel apportés aux résultats au cours de l'exercice	23 127 $
2) Augmentation du coût actuel des immobilisations	322 393 $
Effet de l'inflation	404 833
Excédent de l'inflation sur l'augmentation du coût actuel	82 440 $
3) Gain du pouvoir d'achat général du passif monétaire net	86 382 $

Renseignements supplémentaires sur les réserves

au 31 décembre 1985

	Pétrole	Liquides extraits du gaz naturel	Gaz naturel
	(milliers de mètres cubes)	*(milliers de mètres cubes)*	*(millions de mètres cubes)*
Réserves prouvées moins les redevances au 31 décembre 1984	35 367,0	4 686,0	100 416,4
Révisions des estimations antérieures	1 672,1	1 277,1	(20 414.2)
Ajouts et découvertes	567,3	—	1 185,7
Production	(2 892,5)	(469,6)	(3 325,9)
Réserves prouvées moins les redevances au 31 décembre 1985	34 713,9	5 493,5	77 862,0

Les montants indiqués ne comprennent pas la participation de 17 pour cent de Petro-Canada dans les réserves de pétrole brut synthétique de Syncrude Canada Limited ("Syncrude") (39 102,0 milliers de mètres cubes avant redevances au 31 décembre 1985). Aux termes d'un accord entre la province d'Alberta, bailleur des concessions de sables pétrolifères, et les participants à Syncrude, la province a droit à 50 pour cent du bénéfice net réputé de Syncrude, comme il a été stipulé dans l'accord. Au gré de la province, ce droit peut, conformément aux dispositions de l'accord, être converti en une redevance de 7,5 pour cent de la production brute. La portion de 50 pour cent du bénéfice net réputé et la redevance de 7,5 pour cent de la production brute peuvent toutes deux être modifiées en certaines circonstances. Compte tenu de ces modifications éventuelles et des incertitudes ayant trait aux prix et frais à venir, la Société n'a pas présenté ses réserves de pétrole brut synthétique déduction faite des redevances.

Petro-Canada

Éléments du bilan au coût actuel

au 31 décembre 1985

(en milliers de dollars)

	Tel que divulgués dans les états au coût d'origine	*Selon le coût actuel*
Stocks	1 109 451 $	1 104 957 $
Immobilisations	6 030 165 $	8 201 801 $
Actif net (avoir de l'actionnaire)	3 642 366 $	5 809 508 $

Petro-Canada

État consolidé des résultats au coût actuel

pour l'exercice terminé le 31 décembre 1985

(en milliers de dollars)

	Tel que divulgués dans les états au coût d'origine	*Selon le coût actuel*
Produits		
Exploitation	5 300 097 $	5 300 097 $
Produits des investissements et produits divers	80 834	77 246
	5 380 931	5 377 343
Charges		
Achat de pétrole brut et de produits	2 901 164	2 854 507
Production et raffinage	552 746	552 746
Frais généraux, frais de marketing et d'administration	552 548	552 548
Taxes autres que les impôts sur le revenu	427 576	427 576
Amortissement et épuisement	410 190	548 468
Intérêt sur la dette à long terme	24 264	24 264
	4 868 488	4 960 109
Bénéfice avant les postes ci-dessous	512 443	417 234
Provision pour impôts sur le revenu		
Reportés	295 776	275 042
Exigibles	44 887	44 887
	340 663	319 929
	171 780	97 305
Participation minoritaire	2 100	2 919
Bénéfice net de l'exercice avant éléments inhabituels et dividendes des actions privilégiées rachetables	173 880 $	100 224 $

fait ressortir la composante inflation de l'augmentation totale du coût actuel des immobilisations. La dernière information présentée a trait aux gains du pouvoir d'achat général qui résulte du passif monétaire net. Ceci survient du fait que l'inflation diminue le pouvoir d'achat de la monnaie et, qu'en conséquence, là où il y a un passif monétaire net, on doit reconnaître "gain" du fait que ce passif monétaire net nécessite l'utilisation d'un "pouvoir d'achat" inférieur à mesure que le temps passe en période d'inflation.

Les recommandations de l'ICCA demandent aussi la divulgation de données sur les réserves pétrolières et gazières, déduction faite des redevances. Le tableau des renseignements supplémentaires sur les réserves vous donne cette information.

Renseignements supplémentaires sur la présentation des effets des variations de prix

(non vérifié)

31 décembre 1985

Mode de présentation

Les états financiers de Petro-Canada présentent l'information financière selon les coûts d'origine, conformément aux principes comptables généralement reconnus. Quoique le taux d'inflation ait diminué considérablement au cours des récentes années, l'économie a antérieurement été touchée par des hausses importantes du taux d'inflation et plusieurs des effets engendrés par ces augmentations ne sont pas reflétés dans les états financiers traditionnels. Les frais supplémentaires nécessaires au remplacement des stocks et des immobilisations en main et la détention d'éléments d'actif ou de passif monétaires nets ne sont pas pris en compte dans les états financiers au coût d'origine. L'Institut Canadien des Comptables Agréés (ICCA) a publié des recommandations sur la préparation de l'information présentant les effets des variations de prix. L'ICCA offre ces recommandations à titre expérimental. Le but en est de déterminer si ces renseignements sont utiles aux utilisateurs des états financiers dans leur évaluation d'une entreprise. L'information qui suit a été préparée selon les recommandations de l'ICCA, sauf dans le cas du calcul de la provision pour impôts sur le revenu, dont nous parlerons plus bas.

Petro-Canada a préparé l'information ci-jointe en utilisant des hypothèses qu'elle considère être raisonnables; le lecteur doit cependant noter que les recommandations font appel à un certain degré de jugement subjectif et que des résultats bien différents pourraient être obtenus si d'autres hypothèses, aussi valables, étaient utilisées. En outre, les recommandations reconnaissent le fait que les frais de prospection et de mise en valeur nécessaires au remplacement des réserves de pétrole et de gaz sont l'objet d'un degré élevé d'incertitude. Malgré cela, les recommandations suggèrent d'estimer le coût actuel des réserves de pétrole et de gaz et suggèrent l'utilisation d'indices. Petro-Canada a utilisé cette façon de faire mais vous met en garde: ces estimations des coûts actuels peuvent être trompeuses et ne représentent pas nécessairement les montants auxquels les réserves pourraient être achetées et les frais qu'il faudrait engager dans les périodes à venir pour les remplacer.

Notes explicatives

Le tableau Éléments du bilan au coût actuel donne le coût actuel des stocks et des immobilisations et l'effet des redressements de l'actif net au coût actuel. Le coût actuel des immobilisations a été calculé par l'utilisation d'indices. L'actif net représente l'avoir du détenteur des actions ordinaires au coût d'origine rajusté au coût actuel.

L'État consolidé des résultats au coût actuel vous offre une comparaison de l'état des résultats de la Société selon qu'il est présenté au coût d'origine ou au coût actuel. Le bénéfice de participation a été rajusté pour tenir compte de la part de Petro-Canada dans les rajustements au coût actuel touchant les sociétés affiliées. Les charges au titre des achats de pétrole brut et de produits ont été rajustées pour tenir compte du coût actuel de ces achats au moment de l'utilisation. La charge de l'amortissement a été rajustée pour tenir compte du coût actuel estimatif de remplacement de la capacité de fonctionnement des immobilisations. L'ICCA recommande que le montant de l'impôt sur le revenu pris en compte dans le calcul du bénéfice au coût actuel soit le même que le montant indiqué dans les états financiers au coût d'origine. Toutefois, la Société croit qu'il est plus approprié de redresser la provision pour impôts sur le revenu reportés afin de tenir compte de la baisse du coût des produits vendus et de la hausse de l'amortissement et de l'épuisement. Comme les présents renseignements supplémentaires non vérifiés vous sont donnés à titre expérimental, nous avons tenu compte de tels redressements dans le calcul des impôts sur le revenu reportés présentés dans l'état consolidé des résultats au coût actuel. Si la Société avait suivi les recommandations de l'ICCA touchant la charge d'impôt sur le revenue dans le calcul du bénéfice au coût actuel, la provision pour impôts sur le revenu reportés aurait été de 295 776 000$. Il convient de noter ici que la législation fiscale ne permet présentement pas de déductions pour ces redressements au coût actuel. La participation minoritaire a été rajustée pour tenir compte de sa part du rajustement de la charge d'amortissement au coût actuel.

Le tableau Autres renseignements au coût actuel donne le reste de l'information financière suggérée par les recommandations. Le redressement financier donne la portion du rajustement au coût actuel ayant trait aux éléments de passif monétaires nets de Petro-Canada. L'ICCA en a donné la définition suivante : "fraction de la variation du coût actuel des biens qui correspond au ratio capitaux empruntés — capitaux propres et que l'on n'a donc pas à imputer aux bénéfices actuels ou futurs pour assurer la préservation de la quote-part de la capacité de fonctionnement de l'entreprise revenant aux détenteurs d'actions ordinaires". La seconde partie du tableau

Les éléments d'actif sectoriels au 31 décembre, et le montant des dépenses en immobilisations de l'exercice, par secteur commercial, se présentent comme suit :

	Éléments d'actif sectoriels		*Dépenses en immobilisations**	
	1985	1984	**1985**	1984
Ressources naturelles	**4 509 488 $**	5 444 759 $	**869 341 $**	954 217 $
Produits du pétrole raffiné	**3 808 278**	2 634 699	**168 127**	136 400
Autres	**528 326**	886 706	**(172 277)**	204 586
	8 846 092 $	8 966 164 $	**865 191 $**	1 295 203 $

Les autres éléments d'actif sectoriels comprennent l'encaisse et les dépôts à court terme, les placements dans d'autres sociétés et l'actif général de la Société.

* Les dépenses en immobilisations sont présentées avant déduction des subventions au titre du Programme d'encouragement du secteur pétrolier.

19. Chiffres correspondants

Certains chiffres correspondants de 1984 ont été reclassés afin de les rendre conformes à la présentation de l'exercice courant.

20. Engagements et passif éventuel

a) Engagements
La Société a loué un certain nombre de navires de forage en mer avec tout l'équipement nécessaire en vertu de divers contrats dont le dernier vient à échéance en 1988. Les loyers des navires de forage, lorsque ceux-ci sont utilisés par la Société, sont partagés avec les participants aux co-entreprises. Les navires peuvent être sous-loués lorsqu'ils ne sont pas utilisés par la Société.

La location brute des navires de forage en mer, moins les charges à payer à l'égard des éléments inhabituels (note 13), ainsi que les loyers annuels minimaux afférents au Centre Petro-Canada (note 5) et à d'autres contrats de location-exploitation non résiliables sont estimés à 95 000 000 $ en 1986, à 63 000 000 $ en 1987, à 45 000 000 $ en 1988, à 44 000 000 $ en 1989, à 41 000 000 $ en 1990 et à 15 000 000 $ par année par la suite jusqu'en 2008.

b) Passif éventuel
La Société est partie dans des litiges et réclamations découlant du cours normal des affaires. La direction est d'avis que les règlements éventuels n'auront pas d'effet significatif sur la situation financière de la Société.

18. Information sectorielle

La Société exerce son activité pincipalement dans les secteurs suivants :

Secteur commercial	*Activités*
Ressources naturelles	Exploration, mise en valeur et mise en production de pétrole brut, de gaz naturel, de liquides de terrain, de soufre, de sables pétrolifères; extraction de liquides du gaz naturel; transport, distribution et marketing de liquides extraits du gaz naturel.
Produits du pétrole raffiné	Achat et vente de pétrole brut; raffinage de pétrole brut en produits du pétrole; distribution et marketing de ceux-ci et de produits du pétrole raffiné achetés.

Les résultats financiers des activités par secteur commercial sont les suivants :

	Ressources naturelles		*Produits du pétrole raffiné*		*Éliminations*		*Total consolidé*	
	1985	1984	**1985**	1984	**1985**	1984	**1985**	1984
Ventes aux clients	**971 526 $**	1 450 252 $	**4 328 571 $**	3 431 041 $	**– $**	– $	**5 300 097 $**	4 881 293 $
Transferts intersectoriels	**660 507**	88 572	**–**	–	**(660 507)**	(88 572)	**–**	–
Total des produits d'exploitation	**1 632 033**	1 538 824	**4 328 571**	3 431 041	**(660 507)**	(88 572)	**5 300 097**	4 881 293
Coûts incorporables et frais d'exploitation	**533 559**	534 472	**3 580 858**	2 809 601	**(660 507)**	(88 572)	**3 453 910**	3 255 501
Amortissement et épuisement	**282 979**	250 727	**97 327**	84 833	**–**	–	**380 306**	335 560
Taxes autres que les impôts sur le revenu	**147 795**	121 688	**279 781**	222 096	**–**	–	**427 576**	343 784
	964 333	906 887	**3 957 966**	3 116 530	**(660 507)**	(88 572)	**4 261 792**	3 934 845
Bénéfice d'exploitation	**667 700 $**	631 937 $	**370 605 $**	314 511 $			**1 038 305**	946 448
Frais généraux et frais de marketing et d'administration							**(552 548)**	(403 170)
Provision pour impôts sur le revenu							**(340 663)**	(384 919)
Produits des investissements et produits divers							**80 834**	107 470
Autres amortissements							**(29 884)**	(27 434)
Intérêt sur la dette à long terme							**(24 264)**	(11 324)
Participation minoritaire							**2 100**	4 961
							(864 425)	(714 416)
Bénéfice avant éléments inhabituels et dividendes des actions privilégiées rachetables							**173 880 $**	232 032 $

Les transferts intersectoriels sont comptabilisés à la valeur marchande.

Les revenus tirés du secteur des ressources naturelles sont :

	1985	1984
Pétrole brut et liquides de terrain	**990 178 $**	867 366 $
Liquides extraits du gaz naturel	**301 532**	325 058
Gaz naturel	**291 962**	284 522
Autres	**48 361**	61 878
	1 632 033 $	1 538 824 $

Les revenus tirés du secteur des produits du pétrole raffiné sont :

	1985	1984
Essence	**2 231 710**	1 813 981
Distillats	**1 349 573**	1 025 140
Autres	**747 288**	591 920
	4 328 571 $	3 431 041 $

14. Fonds de roulement provenant de l'exploitation

Le fonds de roulement provenant de l'exploitation se présente comme suit :

	1985	1984
Bénéfice avant éléments inhabituels et dividendes des actions privilégiées rachetables	**173 880 $**	232 032 $
Ajouter (déduire) :		
Amortissement et épuisement	**410 190**	362 994
Impôts sur le revenu reportés	**295 776**	309 418
Bénéfice de participation, moins les dividendes reçus	**(6 594)**	(2 640)
Divers	**(3 014)**	(5 668)
	870 238 $	896 136 $

15. Variation des composantes du fonds de roulement d'exploitation

L'augmentation (la diminution) du fonds de roulement d'exploitation résulte des variations suivantes au cours de l'exercice :

	1985	1984
Comptes clients	**470 485 $**	17 662 $
Stocks	**263 736**	134 709
Impôts sur le revenu recouvrables	**(12 623)**	(4 229)
Dépôts et frais payés d'avance	**11 763**	2 720
Comptes fournisseurs et charges à payer	**(681 247)**	(15 382)
Fonds de roulement d'exploitation obtenu à l'acquisition de Gulf Canada Limitée (note 3)	**(292 610)**	–
Charges à payer relativement aux éléments inhabituels (note 13), et autres charges échéant à moins d'un an	**224 868**	–
	(15 628)$	135 480 $

Le fonds de roulement d'exploitation se compose du fonds de roulement autre que l'encaisse et les dépôts à court terme, les effets à payer à court terme et la tranche de la dette à long terme échéant à moins d'un an.

16. Régimes de retraite

Selon les plus récentes évaluations actuarielles des régimes de retraite de la Société, les obligations non capitalisées au titre des services passés sont d'environ 67 000 000 $ au 31 décembre 1985. Toutes les prestations accumulées, y compris celles acquises, au 31 décembre 1985 sont entièrement capitalisées.

17. Opérations d'importance avec des parties apparentées

La Société a des opérations avec le gouvernement du Canada et avec des institutions gouvernementales; ces opérations ont lieu dans le cours normal des affaires et, en conséquence, aux mêmes conditions qu'avec des parties non apparentées.

Propriétés pétrolifères et gazéifères situées dans des régions éloignées du Canada
Par suite de la chute des prix mondiaux du pétrole et des changements survenus dans le milieu énergétique réel et prévisionnel, la Société a décidé de radier la valeur comptable de certaines propriétés pétrolifères et gazéifères situées dans des régions éloignées du Canada. Par conséquent, les coûts non amortis de ces propriétés ainsi que les provisions qui avaient été constituées en prévision de pertes éventuelles sur les contrats de location de navires de forage en mer et de l'équipement nécessaire, se sont chiffrés à 547 614 000 $ et ils ont été imputés aux résultats (après en avoir déduit les impôts sur le revenu y afférents de 443 081 000 $ et la participation minoritaire de 121 958 000$).

Frais de développement de procédés
La construction d'une usine visant à mettre en application un nouveau procédé d'amélioration du fuel résiduel lourd a été achevée en 1985. La construction de cette usine avait été entreprise conformément à une directive du gouvernement du Canada. En raison des conditions économiques nouvelles, la Société a décidé d'imputer aux résultats les coûts du projet qui s'élevaient à 108 168 000 $ (après en avoir déduit 37 080 000 $ pour les impôts sur le revenu y afférents).

Gisements de sables pétrolifères
En raison de la chute des prix mondiaux du pétrole et compte tenu des incertitudes qui entourent le moment propice à l'exploitation de nouveaux gisements de sables pétrolifères, la Société a décidé de radier la valeur comptable de ses gisements de sables pétrolifères, sauf les projets de production in situ et le Projet Syncrude. En conséquence, le coût non amorti de ces gisements, soit 90 153 000 $, a été imputé aux résultats (après déduction de 49 212 000 $ au titre des impôts sur le revenu y afférents).

Redressement des stocks
Aux termes de l'Accord sur l'énergie dans l'Ouest, la Société n'est plus tenue de vendre sa production albertaine de pétrole brut à la Alberta Petroleum Marketing Commission et donc, depuis le 1er juin 1985, elle fournit du pétrole brut directement à ses raffineries. Ce changement reporte le point de vente, ainsi que la comptabilisation du profit qui en résulte, de la tête de puits à l'endroit où s'effectue l'achat du produit raffiné par le client. Au 31 décembre 1985, les stocks avaient été réduits d'environ 45 354 000 $, lequel montant a été imputé aux résultats (après déduction de 30 680 000 $ pour les impôts sur le revenu y afférents).

Déménagement et réorganisation
La Société annonçait en 1985 son intention de déménager de l'est du Canada à Calgary certaines de ses activités ayant trait au raffinage et au marketing. Elle a de plus mis en oeuvre un programme de réorganisation de ses services internes, qui entraînera une réduction de son effectif. Les frais relatifs à ce déménagement et à cette réorganisation, qui sont évalués à 20 231 000 $ (après déduction de 18 869 000 $ au titre de l'impôt sur le revenu y afférent), ont été imputés aux résultats.

Propriétés pétrolifères et gazéifères situées dans des régions étrangères
La Société a radié la valeur comptable de son centre de frais en Chine, du fait que les travaux d'exploration y ont été infructueux. Conséquemment, elle a imputé 16 715 000 $ aux résultats (après en avoir soustrait 15 043 000 $ pour les impôts sur le revenu y afférents).

Gisements de charbon et de minéraux
En raison de la chute des prix mondiaux du pétrole et compte tenu des incertitudes qui entourent le moment propice à l'exploitation des gisements de charbon et de minéraux, la Société a décidé de radier la valeur comptable de ces propriétés. Le solde du coût de ces gisements, qui se chiffrait à 14 806 000 $, a été imputé aux résultats (après avoir déduit 13 296 000 $ pour les impôts sur le revenu y afférents).

Redésignation du réseau de marketing
La Société a estimé qu'elle avait tiré à peu près tous les avantages économiques des frais relatifs au programme de redésignation du réseau de marketing. Il s'agit de frais qu'elle avait engagés au cours d'exercices antérieurs, qu'elle avait reportés et amortis sur la période au cours de laquelle ces avantages étaient censés se réaliser. Par conséquent, le solde non amorti de ces frais, qui se chiffre à 13 096 000 $ (après en avoir déduit 12 045 000 $ au titre des impôts sur le revenu y afférents), a été imputé aux résultats.

Projet Gaz polaire
Le projet Gaz polaire a récemment soumis à l'Office National de l'Énergie une demande l'autorisant à construire un gazoduc s'étendant du delta du MacKenzie à Edson en Alberta, et a mis de côté son projet pour la construction d'un gazoduc reliant les Îles de l'Arctique à l'est du Canada. Les coûts qui avaient été engagés au cours d'exercices antérieurs pour des études de faisabilité du projet abandonné – et qui avaient été reportés – se sont élevés à 8 764 000 (après en avoir défalqué 8 171 000 $ au titre des impôts sur le revenu y afférents) et ont été imputés aux résultats.

12. Impôts sur le revenu

La provision pour impôts sur le revenu de 340 663 000 $ (1984 – 384 919 000 $) représente un taux réel de 66,5 p. cent (1984 – 62,9 p. cent) sur le bénéfice avant impôts de 512 443 000 $ (1984 – 611 990 000 $). Le calcul de la provision, qui requiert un rajustement du bénéfice avant impôts sur le revenu pour tenir compte des postes non imposables et non déductibles aux fins fiscales, se présente comme suit :

	1985	1984
Bénéfice avant impôts sur le revenu	**512 443 $**	611 990 $
Ajouter (déduire)		
Redevances et autres paiements à des gouvernements provinciaux	**307 096**	327 560
Abattements fédéraux		
Abattement pour ressources	**(259 999)**	(245 909)
Épuisement fiscal	**(21 046)**	(29 268)
Abattement pour stocks	**(29 556)**	(10 498)
Taxes sur les recettes pétrolières et gazières	**123 448**	118 536
Amortissement et épuisement non déductibles	**95 442**	98 661
Participation au bénéfice de sociétés affiliées	**(22 383)**	(17 874)
Gain de change	**(2 781)**	(4 846)
Autres	**5 805**	291
Bénéfice rajusté avant impôts sur le revenu	**708 469 $**	848 643 $
Impôt fédéral canadien sur le revenu à 46,9 % (1984 – 46 %) appliqué au bénéfice rajusté	**332 272 $**	390 375 $
Impôts provinciaux, et autres impôts sur le revenu, déduction faite de l'abattement fédéral	**16 215**	3 624
Programme de dégrèvements provinciaux d'impôt sur le revenu	**(7 824)**	(9 080)
Provision pour impôts sur le revenu	**340 663 $**	384 919 $

13. Éléments inhabituels

Les éléments inhabituels imputés aux résultats de 1985 sont les suivants :

Propriétés pétrolifères et gazéifères situées dans des régions éloignées du Canada	547 614 $
Frais de développement de procédés	108 168
Gisements de sables pétrolifères	90 153
Redressement des stocks	45 354
Déménagement et réorganisation	20 231
Propriétés pétrolifères et gazéifères situées dans des régions étrangères	16 715
Gisements de charbon et de minéraux	14 806
Redésignation du réseau de marketing	13 096
Projet Gaz polaire	8 764
	864 901 $

10. Capital

Autorisé

Globalement, le capital autorisé est le suivant :
a) 71 188 actions ordinaires d'une valeur nominale de 100 000 $ chacune.
b) Actions privilégiées émises au gouvernement du Canada; ces actions et tous les emprunts obtenus, et en cours, en provenance du Fonds du revenu consolidé du gouvernement du Canada ne doivent pas dépasser 1 000 000 000 $.

Émis (au gouvernement du Canada)

	1985		1984	
	Nombre d'actions	*Contrepartie*	*Nombre d'actions*	*Contrepartie*
Actions ordinaires				
Solde au début de l'exercice	**31 883 $**	**3 188 300 $**	27 633 $	2 763 300 $
Au comptant	**–**	**–**	4 250	425 000
Solde à la fin de l'exercice	**31 883**	**3 188 300**	31 883	3 188 300
Actions privilégiées				
Solde au début et à la fin de l'exercice	**972 771 853**	**972 772**	972 771 853	972 772
Total du capital à la fin de l'exercice		**4 161 072 $**		4 161 072 $

Les actions privilégiées ont une valeur nominale de 1 $ chacune et sont rachetables au pair au gré de la Société; elles ne comportent aucun taux de dividende déclaré et le dividende n'est pas cumulatif.

11. Taxes autres que les impôts sur le revenu

Les taxes autres que les impôts sur le revenu sont les suivantes :

	1985	1984
Taxe de vente fédérale	**249 341 $**	184 508 $
Taxe sur les recettes gazières et pétrolières	**123 448**	118 536
Autres taxes	**54 787**	40 740
	427 576 $	343 784 $

8. Dette à long terme

La dette à long terme comporte :

	Échéance	**1985**	1984
En dollars canadiens			
Billets non.garantis 8.25%	1993	**14 375 $**	14 375 $
Billets non garantis 5.75%	1986	**6 961**	6 961
Billets à ordre, portant intérêt au taux préférentiel		**–**	13 192
Emprunts non garantis portant intérêt du taux préférentiel au taux préférentiel majoré de ½%		**–**	9 500
Autres emprunts et obligations à long terme	1986 – 1988	**1 523**	1 923
En dollars américains			
Billets non garantis, au taux LIBOR diminué de 0.8% (125 000 000 $ US)	1995	**174 688**	–
Billets non garantis 9% (41 250 000 $ US)	1996	**57 646**	59 466
Billets non garantis 7,75% (14 000 000 $ US)	1993	**19 565**	21 142
Billets non garantis 8,45% (10 000 000 $ US)	1987	**13 975**	19 821
Hypothèques 5,75% à 6,25% (592 000 $ US)	1988	**828**	2 080
Billets non garantis 5.25%		**–**	8 589
		289 561	157 049
Moins la portion exigible		**20 430**	47 102
		269 131 $	109 947 $

Remboursement de la dette à long terme

Le remboursement minimal de la dette à long terme dans chacun des cinq exercices à venir est le suivant :

1986 – 20 430 000 $
1987 – 13 894 000 $
1988 – 7 700 000 $
1989 – 7 698 000 $
1990 – 7 695 000 $

9. Actions privilégiées rachetables

Les actions privilégiées rachetables, émises par une filiale à un groupe de banques à charte canadiennes, sont des actions privilégiées rachetables, sans droit de vote, à dividende cumulatif à taux variable. Les dividendes cumulatifs, payables trimestriellement, sont basés, selon le choix de la filiale, sur les taux de base des États-Unis ou sur les taux interbancaires de Londres. Le taux de dividende était d'environ 4,6 p. cent par an le 31 décembre 1985. Les actions sont rachetables, au gré de la filiale, à 100 $ US l'action, plus les dividendes accumulés. En 1985, la filiale a exercé son droit de racheter 750 000 actions (700 000 actions en 1984) en contrepartie de 75 000 000 $ US (70 000 000 $ US en 1984) et, au 31 décembre 1985, 10 450 000 actions étaient toujours en circulation.

En vertu des conditions d'une entente entre les banques et la Société, si la filiale n'exerce pas son droit de rachat des actions sur une période de huit ans échéant le 31 décembre 1993, ou si certains événements ont lieu en vertu des dispositions de l'entente, les banques ont le droit d'exiger que la Société achète les actions à 100 $ US chacune, plus les dividendes accumulés. Ces droits de rachat passent de 85 000 000 $ US à 170 000 000 $ US par année sur le reste de la période.

6. Immobilisations

Les immobilisations comprennent :

	1985			1984
	*Coût**	*Amortissement et épuisement cumulés*	*Net*	*Net*
Pétrole et gaz				
Au Canada				
– Régions non éloignées	**3 911 728 $**	**821 373 $**	**3 090 355 $**	3 068 344 $
– Régions éloignées	**1 011 122**	**795 268**	**215 854**	915 270
À l'étranger	**163 394**	**106 786**	**56 608**	81 133
Raffinage et marketing	**2 016 063**	**279 178**	**1 736 885**	1 375 598
Sables pétrolifères				
Projet Syncrude	**618 542**	**92 698**	**525 844**	486 361
Produits in situ	**85 431**	**5 016**	**80 415**	–
Autres concessions de sables pétrolifères	**197 541**	**197 541**	**–**	207 457
Liquides extraits du gaz naturel	**202 865**	**59 674**	**143 191**	128 885
Autres immobilisations	**342 621**	**161 608**	**181 013**	250 892
	8 549 307 $	**2 519 142 $**	**6 030 165 $**	6 513 940 $

* Le coût est indiqué déduction faite des subventions au titre du Programme d'encouragement du secteur pétrolier et des crédits d'impôt à l'investissement.

7. Charges reportées

Les charges reportées comportent :

	1985	1984
Au prix coûtant		
Frais d'enlèvement du mort-terrain des sables pétrolifères	**44 395 $**	41 511 $
Moins portion afférente aux sables pétrolifères qui seront exploités dans l'année	**14 032**	10 730
	30 363	30 781
Projet Gaz polaire	**1 534**	17 617
Au prix amorti		
Redressement de conversion de la dette à long terme	**19 884**	9 085
Programme de redésignation du réseau de marketing	**–**	28 588
Autres	**12 943**	12 101
	64 724 $	98 172 $

4. Stocks

Les stocks se composent de :

	1985	1984
Pétrole brut, produits raffinés et marchandises	**1 043 335 $**	768 774 $
Matériaux et fournitures	**66 116**	76 941
	1 109 451 $	845 715 $

5. Placements

Les placements de la Société se présentent ainsi :

	1985	1984
À la valeur de consolidation		
Westcoast Transmission Company Limited	**181 299 $**	176 984 $
Centre Petro-Canada	**24 091**	222 505
Sedpex Inc.	**22 602**	15 334
Autres	**11 839**	4 418
À la valeur d'acquisition		
Hypothèques et autres placements	**51 012**	43 114
Fonds réservés à des fins d'appel d'offres	**–**	131 879
Canertech Inc.	**–**	–
	290 843 $	594 234 $

Westcoast Transmission Company Limited ("Westcoast")
Au 31 décembre 1985, la Société détenait 31,1 p. cent du total des actions ordinaires en circulation de Westcoast.

Le coût du placement dans Westcoast était supérieur à la valeur comptable nette sous-jacente aux dates d'acquisition. Cet excédent est amorti sur les vies utiles estimatives des éléments d'actif s'y rapportant par une imputation à la part de la Société dans le bénéfice net de Westcoast.

Westcoast est une entreprise de services publics réglementée et est assujettie à des directives de réglementation qui peuvent changer les composantes des frais du service. Les changements résultant de ces directives n'ont pas d'effet direct sur le bénéfice net en raison des considérations du taux de rendement sur la base des tarifs qui entrent aussi en ligne de compte dans le processus de réglementation.

Au 31 décembre 1985, la valeur à la cote du placement de la Société dans Westcoast était de 227 517 000 $ (190 924 000 $ en 1984).

Centre Petro-Canada
Au 31 décembre 1985, la Société détenait une participation de 50 p. cent dans une co-entreprise qui est propriétaire du Centre Petro-Canada, un complexe de bureaux de Calgary. La Société a conclu un contrat de location à long terme en vue d'occuper une partie du complexe (note 20) et a garanti une tranche de 286 000 000 $ de la dette à long terme afférente à ce complexe.

Sedpex Inc.
La Société détenait, au 31 décembre 1985, la moitié de toutes les actions ordinaires en circulation de Sedpex Inc., une société qui est propriétaire d'un navire de forage semi-submersible. Ce navire est actuellement loué à la Société (note 20).

Canertech Inc. ("Canertech")
Les comptes de Canertech, une filiale en propriété exclusive, ont été exclus de la consolidation car on a l'intention ferme de se défaire du placement dans cette filiale. La Société avait constitué Canertech en 1981 afin de mettre en valeur des sources d'énergie de remplacement, à la demande expresse du gouvernement canadien. Celui-ci avait alors fait connaître son intention d'acheter le placement de la Société au prix coûtant et de transformer Canertech en société d'État autonome. Au cours de 1984, le gouvernement a ordonné à la Société de procéder à la dissolution de Canertech. La Société procède présentement à la mise en vigueur de cette directive. Le placement de la Société dans Canertech est inscrit aux livres au coût initial de 1 $.

h) Impôts sur le revenu
La Société fait toutes les provisions nécessaires pour les impôts sur le revenu reportés du fait qu'elle réclame aux fins d'impôt un amortissement, des frais d'exploration et de mise en valeur et d'autres frais qui diffèrent des montants imputés aux résultats dans les états financiers.

i) Conversion des devises étrangères
L'actif à court terme, sauf les stocks et les frais payés d'avance, le passif à court terme et la dette à long terme sont convertis aux taux de change en vigueur à la date du bilan. L'actif à long terme, les stocks, les frais payés d'avance, les impôts sur le revenu reportés et les actions privilégiées rachetables sont convertis aux taux en vigueur à la date de chacune des opérations en cause. Les postes de produits et de charges sont convertis aux taux moyens en vigueur durant l'exercice, à l'exception de l'amortissement corporel et incorporel et de l'épuisement, qui reflètent les taux en vigueur lorsque l'actif a été acquis.

Les gains et les pertes de change qui en résultent sont portés aux résultats, à l'exception des gains et pertes de change non réalisés afférents à la conversion de la dette à long terme, lesquels sont reportés et amortis sur le terme restant de la dette.

Les exploitations étrangères sont considérées comme étant intégrées aux autres activités de la Société et sont donc converties de la façon mentionnée plus haut.

j) Régimes de retraite
Les frais des prestations de retraite pour les services courants des employés sont capitalisés et imputés aux résultats à mesure qu'ils s'accumulent. Les frais découlant de modifications apportées aux régimes en ce qui a trait aux services des employés au cours d'exercices antérieurs ainsi que les insuffisances sont capitalisés conformément aux lois pertinentes régissant les régimes de retraite et sont imputés aux résultats sur des périodes ne dépassant pas quinze ans.

2. Modification de convention comptable

Au cours de 1985, la Société a modifié sa méthode de comptabilisation des crédits d'impôt à l'investissement, conformément aux recommandations de l'Institut Canadien des Comptables Agréés. Les crédits d'impôt à l'investissement, qui antérieurement étaient comptabilisés selon la méthode d'imputation à l'exercice, sont désormais inscrits selon la méthode de réduction des coûts. Cette modification a été appliquée rétroactivement et les états financiers de l'exercice précédent ont été retraités en conséquence.

L'effet de ce changement sur les résultats de 1985 a été d'entraîner une augmentation de la perte nette de l'exercice après dividendes des actions privilégiées rachetables d'environ 13 483 000 $.

3. Acquisitions

a) Éléments d'actif de raffinage et marketing de Gulf Canada Limitée ("Gulf")
Avec effet le 30 septembre 1985, la Société s'est portée acquéreur de certains éléments d'actif de raffinage et de marketing de Gulf en contrepartie d'un versement initial en espèces de 611 000 000 $. Des coûts supplémentaires de l'ordre de 102 947 000 $, relativement à cette acquisition, ont été comptabilisés.

L'actif net acquis, à la valeur attribuée, se compose de :

Immobilisations	406 850 $
Placements	14 487
Fonds de roulement net	292 610
	713 947 $

En outre, la Société a convenu d'acheter les éléments d'actif de la raffinerie d'Edmonton pour un montant global en espèces de 275 000 000 $ d'ici le 27 février 1987 ou trente jours après la dissolution de la société en nom collectif qui détient présentement les droits de propriété sur ces éléments d'actif, selon la plus rapprochée de ces dates.

b) Produits Petro-Canada Inc. ("Produits")
Aux termes d'un appel d'offres daté du 28 février 1983, la Société s'est engagée à acquérir toutes les actions avec et sans droit de vote de Produits (anciennement Raffinage et Marketing BP Canada Limitée). Au cours de 1985, la Société a parachevé son acquisition de Produits en achetant le reste des actions sans droit de vote en contrepartie de 301 953 000 $, y compris les frais connexes. Le coût d'achat total des actions de Produits a été de 424 704 000 $.

Les fonds destinés à l'achat d'actions en 1985 provenaient des fonds réservés à des fins d'appel d'offres et d'une émission de titres d'emprunt à long terme.

Notes des états financiers consolidés

31 décembre 1985

(les montants dans les tableaux sont indiqués en milliers de dollars)

1. Résumé des principales pratiques comptables

a) Principes de consolidation

Les états financiers consolidés comprennent les comptes de Petro-Canada, un agent de sa Majesté du chef du Canada, et de toutes ses filiales (la "Société") à l'exception de ceux de Canertech Inc., dont l'exclusion est expliquée à la note 5.

L'excédent de la contrepartie versée pour les actions des filiales sur leur valeur comptable nette sous-jacente aux dates d'acquisition a été réparti à l'actif connexe acquis et est amorti sur la durée utile de cet actif.

b) Stocks

Les stocks sont évalués au prix coûtant ou à la valeur de réalisation nette, selon le moins élevé des deux.

c) Placements

La Société comptabilise ses placements dans les sociétés sur lesquelles elle exerce une influence prépondérante selon la valeur de consolidation et les autres placements à long terme, selon la valeur d'acquisition.

d) Immobilisations

La Société a adopté, pour ses propriétés pétrolifères et gazéifères, la méthode de capitalisation du coût entier selon laquelle tous les frais se rapportant à l'exploration et à l'exploitation des réserves pétrolifères et gazéifères sont capitalisés. Ces frais incluent les frais d'acquisition des concessions, les dépenses se rapportant aux travaux de géologie et de géophysique, les frais de location des terrains inexploités, les frais de forage tant des puits productifs que des puits improductifs et les frais généraux ayant trait à l'exploration. La Société applique un "critère de plafonnement" aux frais capitalisés de chaque centre de frais en opération afin d'assurer que ces frais ne dépassent pas les produits nets estimatifs devant être tirés de la production obtenue des réserves prouvées et ce, en termes de prix de vente et de frais d'exploitation en vigueur à la date du bilan, plus la juste valeur marchande estimative des gisements non évalués.

On a établi des centres de frais séparés pour les régions du Canada autres que les régions éloignées, pour le Projet Syncrude, la production in situ de sables pétrolifères, les autres concessions de sables pétrolifères et pour chacune des régions éloignées du Canada ainsi que pour chacune des régions étrangères où la Société détient un intérêt.

Les frais d'intérêt de la dette attribuable à la construction de nouvelles installations importantes sont capitalisés au cours de la période de construction.

La plupart des activités d'exploration et de production de la Société relativement au pétrole et au gaz sont menées conjointement avec d'autres parties. Les états financiers ne tiennent compte que de l'intérêt proportionnel de la Société dans ces activités.

e) Amortissement et épuisement

Les frais engagés dans les centres de frais des régions autres que les régions éloignées du Canada, dans le Projet Syncrude, dans la production in situ de sables pétrolifères et dans les centres de frais des régions étrangères productives sont amortis ou épuisés séparément selon la méthode de l'amortissement proportionnel au rendement basé sur les estimations des réserves prouvées de pétrole et de gaz récupérable. Pour fins de calcul de l'amortissement et de l'épuisement, la production de gaz naturel et les réserves sont converties en unités équivalentes de pétrole brut basées sur le contenu énergétique relatif de chaque produit. Les frais annuels engagés dans les autres centres de frais sont amortis selon la méthode linéaire durant toute la période au cours de laquelle on prévoit poursuivre les travaux d'exploration de ces régions. Quand l'exploration s'avère fructueuse, c'est-à-dire quand des réserves de qualité commerciale sont mises au jour, on interrompt l'amortissement et on calcule l'épuisement du solde non amorti du centre de frais selon la méthode de l'amortissement proportionnel au rendement une fois que la production a débuté. Lorsque les résultats de l'exploration sont négatifs, et que le centre de frais est condamné ou abandonné, le solde non amorti de ce centre est alors imputé aux résultats.

L'amortissement des autres immobilisations se fait selon la méthode de l'amortissement proportionnel au rendement ou selon la méthode de l'amortissement linéaire, comme il convient. Les taux de l'amortissement linéaire sont calculés en fonction de la durée de vie utile estimative de l'élément d'actif correspondant.

f) Charges reportées

Les frais relatifs à l'enlèvement du mort-terrain des sables pétrolifères qui feront l'objet d'exploitation dans les années à venir sont reportés et seront imputés aux résultats lorsque lesdits sables pétrolifères seront exploités.

g) Programme canadien d'indemnisation pétrolière

L'indemnisation versée en vertu du Programme canadien d'indemnisation pétrolière pour les importations de pétrole est inscrite comme réduction des achats de pétrole brut et de produits. L'indemnisation qui est versée à la Société pour le brut synthétique est incluse dans les produits d'exploitation.

État consolidé de l'évolution de la situation financière

Pour l'exercice terminé le 31 décembre 1985

(en milliers de dollars)

	1985	1984
		(retraité)
Fonds autogénérés		
Fonds de roulement provenant de l'exploitation (note 14)	**870 238 $**	896 136 $
Produit de la vente d'immobilisations	**63 979**	51 454
Avances sur les livraisons futures de gaz naturel	**(27 948)**	20 266
Fonds autogénérés	**906 269**	967 856
Activités de placement		
Acquisition des éléments d'actif de Gulf Canada Limitée (note 3)	**713 947**	–
Dépenses affectées aux immobilisations	**1 059 192**	1 130 965
Subventions au titre du Programme d'encouragement du secteur pétrolier	**(348 526)**	(380 304)
Augmentation (diminution) des placements, net	**(329 772)**	282 103
(Augmentation) diminution de la participation minoritaire dans des filiales	**295 755**	(1 859)
Augmentation (diminution) du fonds de roulement d'exploitation (note 15)	**(15 628)**	135 480
Augmentation des charges reportées	**3 892**	14 014
	1 378 860	1 180 399
Activités de financement et dividendes		
Produit de l'émission d'effets à payer à court terme, net	**531 539**	–
Produit de l'émission de titres d'emprunt à long terme	**165 275**	–
Rachat d'actions privilégiées rachetables	**(104 663)**	(92 435)
Dividendes – actions privilégiées rachetables	**(78 314)**	(100 083)
– actions ordinaires	**(50 000)**	–
Réduction de la dette à long terme	**(46 409)**	(42 704)
Émission d'actions ordinaires	**–**	425 000
	417 428	189 778
Diminution de l'encaisse	**55 163**	22 765
Encaisse et dépôts à court terme, au début de l'exercice	**32 819**	55 584
Encaisse et dépôts à court terme (insuffisance), à la fin de l'exercice	**(22 344) $**	32 819 $

État consolidé des bénéfices non répartis

Pour l'exercice terminé le 31 décembre 1985

(en milliers de dollars)

	1985	1984
Bénéfices non répartis au début de l'exercice, tels que déclarés précédemment	**353 046 $**	212 027 $
Application rétroactive de la modification de convention comptable à l'égard des crédits d'impôt à l'investissement (note 2)	**(98 078)**	(78 578)
Bénéfices non répartis au début de l'exercice, tels que retraités	**254 968**	133 449
Bénéfice net (perte) de l'exercice avant dividendes des actions privilégiées rachetables	**(691 021)**	232 032
Dividendes – actions privilégiées rachetables	**(78 314)**	(100 083)
– actions ordinaires	**(50 000)**	–
Redressement de change sur le rachat des actions privilégiées rachetables	**(16 800)**	(10 430)
Virement du surplus d'apport	**62 461**	–
Bénéfices non répartis (déficit) à la fin de l'exercice	**(518 706) $**	254 968 $

État consolidé des résultats

Pour l'exercice terminé le 31 décembre 1985

(en milliers de dollars)

	1985	1984 (retraité)
Produits		
Exploitation	**5 300 097 $**	4 881 293 $
Produits des investissements et produits divers	**80 834**	107 470
	5 380 931	4 988 763
Charges		
Achats de pétrole brut et de produits	**2 901 164**	2 780 170
Production et raffinage	**552 746**	475 331
Frais généraux et frais de marketing et d'administration	**552 548**	403 170
Taxes autres que les impôts sur le revenu (note 11)	**427 576**	343 784
Amortissement et épuisement	**410 190**	362 994
Intérêt sur la dette à long terme	**24 264**	11 324
	4 868 488	4 376 773
Bénéfice avant les postes ci-dessous	**512 443**	611 990
Provision pour impôts sur le revenu (note 12)		
Reportés	**295 776**	309 418
Exigibles	**44 887**	75 501
	340 663	384 919
	171 780	227 071
Participation minoritaire	**2 100**	4 961
Bénéfice avant éléments inhabituels et dividendes des actions privilégiées rachetables	**173 880**	232 032
Éléments inhabituels (note 13)	**864 901**	–
Bénéfice net (perte) de l'exercice avant dividendes des actions privilégiées rachetables	**(691 021)**	232 032
Dividendes des actions privilégiées rachetables (note 9)	**78 314**	(100 083)
Bénéfice net (perte) de l'exercice après dividendes des actions privilégiées rachetables	**(769 335) $**	131 949 $

Passif et avoir de l'actionnaire	1985	1984 (retraité)
Passif à court terme		
Chèques en circulation, moins l'encaisse	**22 344 $**	– $
Effets à court terme à payer	**531 539**	–
Comptes fournisseurs et charges à payer	**1 489 160**	807 913
Tranche de la dette à long terme échéant à moins d'un an	**20 430**	47 102
	2 063 473	855 015
Passif à long terme	**197 516**	–
Dette à long terme (note 8)	**269 131**	109 947
Avances sur les livraisons futures de gaz naturel	**145 488**	173 436
Participation minoritaire dans des filiales	**–**	419 813
Impôts sur le revenu reportés	**1 303 901**	1 617 372
Actions privilégiées rachetables (note 9)	**1 224 217**	1 312 080
Capital (note 10)	**4 161 072**	4 161 072
Surplus d'apport	**–**	62 461
Bénéfices non répartis (déficit)	**(518 706)**	254 968
	3 642 366	4 478 501
	8 846 092 $	8 966 164 $

Petro-Canada

Bilan consolidé

Au 31 décembre 1985

(en milliers de dollars)

Actif	1985	1984
		(retraité)
Actif à court terme		
Encaisse et dépôts à court terme	– $	32 819 $
Comptes clients	**1 307 339**	836 854
Stocks (note 4)	**1 109 451**	845 715
Impôts sur le revenu récupérables	**10 413**	23 036
Dépôts et frais payés d'avance	**33 157**	21 394
	2 460 360	1 759 818
Placements (note 5)	**290 843**	594 234
Immobilisations, net (note 6)	**6 030 165**	6 513 940
Charges reportées (note 7)	**64 724**	98 172
	8 846 092 $	8 966 164 $

Approuvé au nom du Conseil

administrateur

administrateur

Responsabilité de la direction pour les états financiers

Les états financiers ont été préparés par la direction conformément aux principes comptables généralement reconnus et appropriés dans les circonstances. La direction est responsable des autres renseignements contenus dans le rapport annuel et qui correspondent, le cas échéant, à ceux contenus dans les états financiers. La direction est aussi chargée de mettre en place et de maintenir un système de contrôle interne qui offre une assurance raisonnable quant à la fiabilité des renseignements financiers produits. La Société bénéficie en outre d'un service de vérification interne qui a notamment pour fonction d'évaluer le système de contrôle interne afin de s'assurer que celui-ci est approprié et qu'il fonctionne convenablement.

Le Conseil d'administration est tenu de s'assurer que la direction remplit ses obligations concernant les rapports financiers et le contrôle interne. Le Conseil assume ses responsabilités par l'entremise de son comité de vérification, composé en majorité d'administrateurs qui ne sont pas à l'emploi de la Société.

Le comité rencontre la direction, les vérificateurs internes et les vérificateurs externes pour s'assurer qu'ils s'acquittent bien de leurs responsabilités et pour examiner les états financiers.

Les vérificateurs externes effectuent un examen indépendant, conformément aux normes de vérification généralement reconnues, et donnent leur avis sur les états financiers. Leur vérification comporte un examen et une évaluation du système de contrôle interne de la Société ainsi que des sondages et des procédés appropriés pour s'assurer de façon raisonnable que les états financiers présentent fidèlement la situation de l'entreprise. Les vérificateurs externes ont pleinement accès au comité de vérification du Conseil d'administration.

Rapport des vérificateurs

L'honorable Pat Carney, C.P., député
Ministre de l'Énergie, des Mines et des Ressources
Chambre des Communes
Ottawa, Canada

Nous avons vérifié le bilan consolidé de Petro-Canada au 31 décembre 1985 ainsi que les états consolidés des résultats, des bénéfices non répartis et de l'évolution de la situation financière de l'exercice terminé à cette date. Notre vérification a été effectuée conformément aux normes de vérification généralement reconnues et a comporté par conséquent les sondages et les autres procédés que nous avons jugés nécessaires dans les circonstances.

À notre avis, ces états financiers consolidés présentent fidèlement la situation financière de la Société au 31 décembre 1985 ainsi que les résultats de son exploitation et l'évolution de sa situation financière pour l'exercice terminé à cette date, selon les principes comptables généralement reconnus et, appliqués de la même manière qu'au cours de l'exercice précédent, après répercussion rétroactive de la modification de la méthode de comptabilisation des crédits d'impôt à l'investissement, dont il est question à la note 2 des états financiers consolidés.

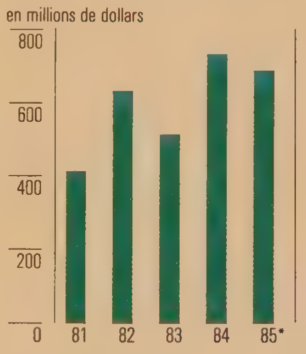
Nous sommes en outre d'avis que les activités de la Société et de ses filiales en propriété exclusive consolidées dont nous avons pris connaissance au cours de notre vérification des états financiers consolidés de Petro-Canada étaient, sous tous les aspects importants, conformes à la Loi sur l'administration financière et aux règlements adoptés aux termes de celle-ci, à la charte et aux règlements de la Société et de ses filiales en propriété exclusive consolidées et à toutes les directives données à la Société.

Peat, Marwick, Mitchell & Cie
Comptables agréés

Arthur Andersen & Cie
Comptables agréés

Calgary (Alberta)
Le 20 février 1986

Dépenses en immobilisations, déduction faite des subventions au titre du Programme d'encouragement du secteur pétrolier



* Exclut les éléments d'actif acquis de Gulf Canada Limitée

Dépenses en immobilisations

Si on exclut l'acquisition des éléments d'actif de Gulf, les dépenses en immobilisations, déduction faite des subventions au titre du Programme d'encouragement du secteur pétrolier, ont été de 711 000 000 $, comparativement à 751 000 000 $ en 1984.

Les dépenses en immobilisations afférentes aux gisements de pétrole classique et de gaz situés dans l'Ouest canadien se sont élevées à 237 000 000 $, y compris une somme de 21 000 000 $ affectée aux importants programmes de forage de Brazeau River et de Bellshill Lake. La quote-part des dépenses de la Société, dans l'usine d'extraction de sables pétrolifères de Syncrude et dans la production in situ de sables pétrolifères de Wolf Lake, a atteint 59 000 000 $ et 13 000 000 $, respectivement. De plus, 23 000 000 $ ont été affectés à la construction de l'usine d'extraction de dérivés liquides du gaz naturel de Taylor (Colombie-Britannique). Dans les régions éloignées du Canada, notamment sur les Grands bancs de Terre-Neuve, sur le plateau de la Nouvelle-Écosse et dans les régions de Beaufort et du Mackenzie, les dépenses ont totalisé 147 000 000 $. Les dépenses en immobilisation en aval se sont élevées à 156 000 000 $, y compris une somme de 45 000 000 $ consacrée à la construction du nouveau craqueur catalytique de la raffinerie de Montréal.

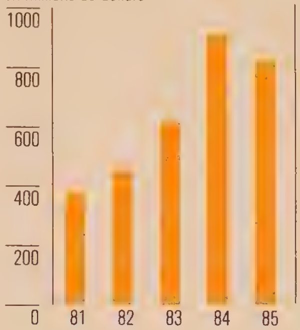
Les éléments d'actif de raffinage et de marketing de Gulf, y compris le fonds de roulement y afférent, ont été achetés au comptant contre 611 000 000 $. De plus, il a été convenu que la Société acquerrait, contre 275 000 000 $, la raffinerie de Gulf située à Edmonton. Cette transaction devrait être réglée dans le premier semestre de 1986.

Actif net

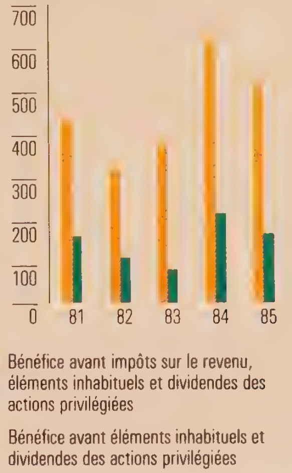
Au 31 décembre 1985, l'actif consolidé de la Société atteignait 8 846 000 000 $ et se ventilait ainsi : actif à court terme, 2 460 000 000 $; placements, 291 000 000 $; immobilisations, 6 030 000 000 $; frais reportés, 65 000 000 $.

Les déductions au titre du passif, de la participation minoritaire dans les filiales, des impôts sur le revenu reportés et des actions privilégiées émises par une filiale ont donné lieu à un actif net de 3 642 000 000 $.

Fonds autogénérés disponibles pour le réinvestissement, le remboursement de la dette et le paiement des dividendes des actions ordinaires



Bénéfice



étaient de 828 000 000 $, soit une baisse de 40 000 000 $ ou de 5 pour cent par rapport à 1984. Au titre des dividendes d'actions ordinaires, la Société a payé 50 000 000 $ au gouvernement du Canada, au cours de 1985.

La Société continue d'accorder une grande importance à ses fonds autogénérés, qu'elle considère comme le principal indice de sa santé financière et de son aptitude à survivre et à croître en dépit du climat d'incertitude qui imprègne encore aujourd'hui le milieu des affaires. Les investisseurs sont habituellement portés à se soucier d'abord du bénéfice; ce sont cependant les fonds autogénérés – soit, en termes simples, la différence entre, d'une part, le produit que la Société tire de la vente de ses ressources naturelles et de ses produits raffinés et, d'autre part, la dépense qu'elle doit faire pour obtenir ce revenu – qui permettent de financer l'exploitation et l'expansion des divers secteurs d'activité de la Société. La rentabilité se mesure plus objectivement par les fonds autogénérés que par le bénéfice. Une fois déduits des fonds autogénérés pour déterminer le bénéfice, les frais hors caisse associés à l'épuisement et à l'amortissement indiquent le coût des éléments d'actif de la Société. Si ces frais hors caisse sont élevés, c'est que la croissance de la Société s'explique par les acquisitions qu'elle a dû faire dans les dix dernières années, en pleine période de cherté, plutôt que par une croissance interne répartie sur plusieurs décennies. Puisque l'excédent du prix coûtant des sociétés acquises sur leur valeur comptable n'était pas déductible aux fins de l'impôt sur le revenu, la croissance par acquisition qui a caractérisé la Société a exercé sur son bénéfice un effet particulièrement défavorable.

Bénéfice

Le bénéfice avant impôts sur le revenu, éléments inhabituels et dividendes des actions privilégiées s'est chiffré à 512 000 000 $, soit 100 000 000 $ ou 16 pour cent de moins qu'en 1984. Une provision de 341 000 000 $ a été constituée pour les impôts sur le revenu, dont une tranche de 296 000 000 $ est reportée, l'autre, soit 45 000 000 $, étant exigible. On notera que le taux d'imposition réel du bénéfice avant impôts sur le revenu est élevé – 66 pour cent – si on le compare au taux d'imposition combiné du fédéral et du provincial, qui se situe à environ 48 pour cent. Cela découle du fait que, dans le calcul de leur revenu imposable, les producteurs de pétrole et de gaz ne sont pas autorisés à déduire les paiements qu'ils font au titre des redevances, ni les taxes sur les recettes pétrolières et gazières. S'ajoute à cela, dans le cas de la Société, le fait que le taux d'imposition réel est singulièrement augmenté en raison de l'impossibilité de déduire l'excédent du prix coûtant des sociétés acquises sur leur valeur comptable, comme nous l'avons déjà mentionné. Le bénéfice avant éléments inhabituels et dividendes des actions privilégiées était de 174 000 000 $, soit une baisse de 58 000 000 $ ou de 25 pour cent par rapport à 1984.

En conséquence de l'imputation des éléments inhabituels, le bénéfice a chuté de 865 000 000 $. Cependant, ainsi que nous l'avons déjà indiqué, cette opération comptable, si elle a eu pour effet de réduire le bénéfice, n'a eu aucune incidence sur les fonds autogénérés de la Société, en 1985.

La Société a payé 78 000 000 $ au titre des dividendes d'actions privilégiées rachetables, comparativement à 100 000 000 $ en 1984. Cette baisse résulte des rachats d'actions effectués en 1985, et du fait que le taux de dividende était alors plus bas.

Revue financière

En 1985, en termes de bénéfice d'exploitation et de fonds autogénérés, la Société a connu des résultats substantiels, quoique inférieurs à ceux de 1984. La production de pétrole classique a été légèrement inférieure à celle de 1984, en raison de contraintes inhérentes au gazoduc. Cependant, la production de pétrole synthétique, de gaz naturel et de dérivés liquides du gaz naturel a atteint de nouveaux sommets. La rentabilité des activités de raffinage et de marketing a gravement souffert du fait que le marché est encore caractérisé par une surcapacité de raffinage et par une très forte concurrence.

Avec effet le 30 septembre 1985, la Société a acquis les éléments d'actif de raffinage, de marketing et de transport de Gulf Canada Limitée situés à l'ouest du Québec. Dans la comparaison des résultats de 1985 et de 1984, on doit tenir compte du fait que ceux de 1985 comprennent les résultats d'exploitation de Gulf pour le dernier trimestre de l'exercice.

Les prix mondiaux du pétrole continuent de baisser, et l'avenir présente la perspective de prix encore plus bas que prévu. En conséquence, la Société a décidé de dévaluer ses actifs, principalement ceux qui sont affectés aux travaux d'exploration dans certaines régions éloignées du Canada. Bien que ces régions renferment d'importantes réserves de pétrole et de gaz, la Société considère comme peu vraisemblable, compte tenu du milieu énergétique réel et prévisionnel, que ces réserves donnent lieu à quelque exploitation commerciale importante dans un délai économique raisonnable. Les coûts afférents à ces travaux d'exploration en régions éloignées, de même que la provision pour pertes éventuelles sur les contrats de location de navires de forage en mer, ont été imputés aux résultats et sont compris dans la somme de 865 000 000 $ inscrite à la rubrique Éléments inhabituels, dans l'État consolidé des résultats. Cette somme, déduction faite des impôts, comprend d'autres frais inhabituels dont ceux, précédemment reportés, qui ont trait aux études de faisabilité du gazoduc de l'Arctique et au développement de procédés. La note 13 afférente aux états financiers consolidés donne la liste et la description détaillée des éléments inhabituels. Puisque la Société a amorti sur des périodes variables les coûts qu'elle a encourus en régions éloignées, la radiation des valeurs comptables correspondantes entraînera une légère élévation des revenus dans les années à venir. On doit cependant remarquer que les éléments inhabituels, s'ils ont réduit le bénéfice net de la Société en 1985, n'ont pas eu d'effet sur ses fonds autogénérés.

Au cours de 1985, la Société a modifié sa méthode de comptabilisation des crédits d'impôt à l'investissement, conformément aux recommandations de l'Institut Canadien des Comptables Agréés. Ces crédits, qui étaient jusque là imputés à la provision pour impôts sur le revenu, ont depuis été portés en diminution des coûts des éléments d'actif correspondants. Cette modification a été appliquée rétroactivement et les états financiers de l'exercice précédent ont été retraités en conséquence.

Fonds autogénérés

Bien qu'importants, les fonds autogénérés de la Société, soit 906 000 000 $, ont marqué une baisse par rapport au chiffre record (968 000 000 $) inscrit pour l'exercice précédent. Cette baisse s'explique en partie par la diminution de l'apport découlant des activités de raffinage et de marketing ainsi que par l'augmentation des frais de financement associés à l'acquisition des éléments d'actif de Gulf.

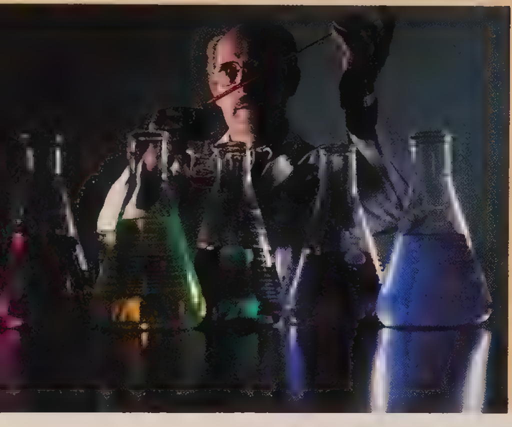
Après déduction des dividendes des actions privilégiées, les fonds disponibles pour le réinvestissement, le remboursement de la dette et le paiement des dividendes des actions ordinaires

stocks et le contrôle financier, ainsi que le recours aux systèmes de gestion, permettent de rentabiliser les activités de vente et de distribution. Ces améliorations sont particulièrement avantageuses, la concurrence étant de plus en plus vive dans notre secteur d'activité, en raison de la déréglementation du marché; en effet, il sera d'une importance primordiale d'agir au moment opportun et de tenir compte de l'efficacité de l'exploitation par rapport aux coûts.

Petro-Canada sur la voie de la réussite
En 1985, Petro-Canada s'est adaptée à l'évolution de la conjoncture en faisant l'acquisition des actifs de Gulf, en continuant de mettre l'accent sur la qualité des services à la clientèle et en consentant des investissements visant à améliorer l'efficacité et la fiabilité de la raffinerie de Montréal. En outre, la Société exploite les possibilités qu'offrent la déréglementation des prix et des marchés du pétrole brut.

On poursuivra l'intégration des actifs acquis auprès de Gulf, ce qui devrait se traduire par de nouvelles économies de coûts en 1986. Par sa présence à la fois plus étendue et mieux équilibrée dans l'ensemble du pays, Petro-Canada est devenue un concurrent plus sérieux dans le secteur du raffinage et de la commercialisation.

Un nouveau craqueur catalytique augmente l'efficacité des travaux à la raffinerie de Montréal.



En plus de mettre à l'essai un éventail complet de lubrifiants de toute première qualité, Petro-Canada en fabrique et les met en marché.

L'expansion du secteur des lubrifiants pour un meilleur service

Le service offert par Petro-Canada aux Canadiens a pris un nouvel essor. Grâce à l'acquisition de Gulf, Petro-Canada est devenue un producteur important de lubrifiants de grande qualité. Ces lubrifiants traités à l'hydrogène sont reconnus pour leur pureté, leur durabilité et leur rendement. Ces qualités exceptionnelles permettent à Petro-Canada de livrer une lutte efficace à la concurrence dans tous les secteurs importants des marchés des entreprises et du détail pour les lubrifiants universels et spécialisés.

Grâce à la technologie, coûts réduits et perspectives accrues

Petro-Canada fait appel aux techniques et aux méthodes les plus modernes pour permettre à ses raffineries de satisfaire aux exigences du marché jusqu'à la fin des années 1980 et pendant les années 1990.

À la raffinerie de Montréal, un nouveau craqueur catalytique a été mis en service en novembre 1985. Grâce à cette nouvelle unité, produit de la technologie moderne, on fabrique de l'essence plus efficacement qu'avec l'ancienne unité qu'elle remplace. D'autres travaux réalisés en 1985 permettent à la raffinerie de fonctionner désormais avec plus d'efficacité et de fiabilité; de plus, une amélioration s'est fait sentir au niveau des effets sur l'environnement.

La construction de l'unité-témoin CANMET à la raffinerie de Montréal a été achevée et les essais ont débuté à la fin de 1985. Une fois en service, cette installation convertira le pétrole lourd en essence et en distillats.

En 1985, des études techniques ont mis l'accent sur l'accroissement de l'efficacité des raffineries grâce à l'utilisation de commandes informatiques et à de nouvelles possibilités d'économie d'énergie et d'amélioration de rendement.

La mise au point de systèmes informatiques améliorés pour la gestion des

Un entrepôt automatisé pour les produits pétroliers empaquetés facilite la liaison entre les services de fabrication et les ventes au détail.

transport et de la commercialisation. En raison de cette décision, la Société est désormais mieux en mesure de servir ses clients et de donner aux Canadiens un accès plus grand à ses services.

Dans l'ouest du pays, Petro-Canada a entrepris l'année avec un réseau de distribution modeste et une présence limitée sur de nombreux marchés. Désormais, grâce à un excellent réseau de dépôts de vrac, de centres agricoles et de stations-service, Petro-Canada détient une part prépondérante du marché et peut avoir accès avec efficacité à l'ensemble du marché de l'Ouest. L'usine d'asphalte de Moose Jaw en Saskatchewan, plusieurs participations dans des pipelines et les intérêts restants dans la propriété de la raffinerie de Port Moody en Colombie-Britannique dotent la Société de meilleurs moyens de traitement et de transport. Au début de 1986, Petro-Canada fera également l'acquisition de la raffinerie d'Edmonton, qui est à la fois une des plus efficaces et des plus perfectionnées du pays.

En Ontario, les nouvelles stations-service dans le Nord, en bordure de grandes autoroutes et dans certaines agglomérations, permettent à la Société de compter sur un réseau de distribution complet. Petro-Canada a en outre fait l'acquisition d'une installation de fabrication de lubrifiants et d'un centre de recherche imposant.

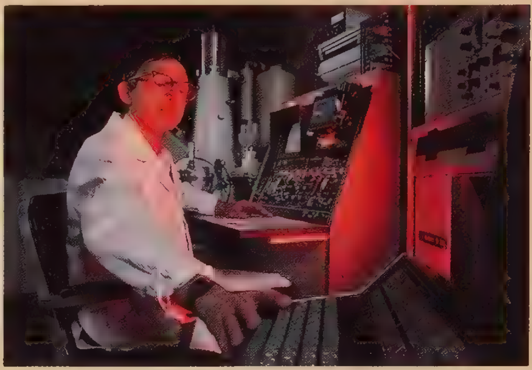
En plus d'assurer sa présence dans l'ensemble du pays, cette acquisition a donné de l'ampleur à la gamme des produits et des services offerts par Petro-Canada aux consommateurs. La Société fabrique et commercialise une gamme complète de produits, en plus d'offrir un soutien technique pour l'ensemble de ces produits, ce qui est avantageux pour toutes les catégories de clientèle. Dans le domaine du détail, les services offerts comprennent désormais des installations de graissage rapide et un plus grand nombre de lave-autos et de dépanneurs.

Le client d'abord

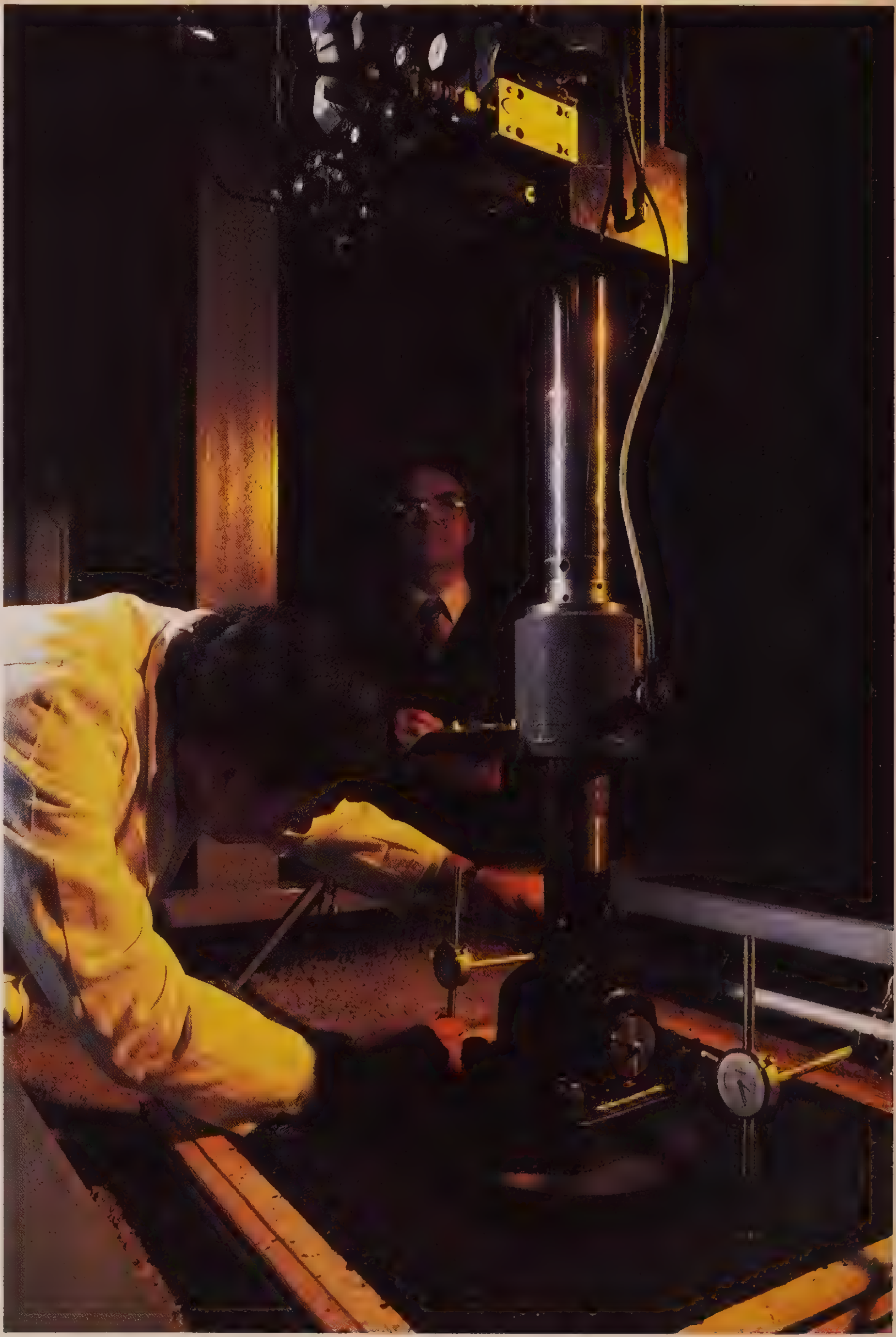
Grâce à son image authentiquement canadienne et à ses initiatives sur le marché, Petro-Canada, bien qu'elle soit une entreprise relativement jeune, a gagné la faveur du grand public. La Société sait que la réussite commerciale repose sur la fidélité de ses clients, qu'elle ne peut gagner qu'en offrant un service de toute première qualité.

Petro-Canada a réaffirmé sa volonté de donner satisfaction à sa clientèle en mettant l'accent sur la qualité des services offerts partout dans l'entreprise. Tant au siège social que dans les régions, cette stratégie est prioritaire pour la direction et fait ressortir, pour nos employés, nos détaillants et nos relations d'affaires, l'importance vitale du client pour le succès de la Société.

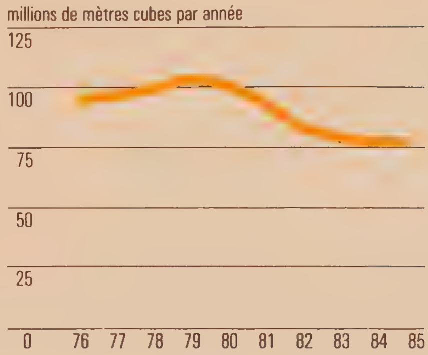
Pendant toute l'année 1985, des programmes précis de recherche commerciale ont été lancés afin de s'assurer que les besoins de nos clients sont pris en considération dans les décisions commerciales et que des normes rigoureuses sont respectées dans nos établissements de détail. Pour montrer à la clientèle notre détermination dans ce sens, nous avons insisté davantage sur des programmes relatifs à la formation des détaillants et des agents et à la participation à la vie de la collectivité.



Les clients bénéficient des travaux de mise en valeur et des essais réalisés au Centre de recherche de Sheridan Park, en Ontario.



Les ventes de produits pétroliers ont baissé pour toute l'industrie



Division Produits – Points saillants

Durant l'exercice de 1985, Petro-Canada a adapté ses activités selon les défis lancés dans un contexte économique difficile. Toutefois, ses résultats financiers n'ont pas été très satisfaisants.

Au début des années 1980, la demande de produits pétroliers au Canada a considérablement fléchi. Au cours des deux dernières années, cette tendance à la baisse s'est stabilisée. Il n'en reste pas moins que la demande actuelle reste inférieure d'environ 25 pour cent aux niveaux de 1979. Les secteurs du raffinage et de la commercialisation continuent d'être caractérisés par la faible utilisation des raffineries et des stations-service, des coûts élevés et des fermetures d'installations. La capacité excédentaire a intensifié la concurrence et fait baisser les prix, les entreprises ayant fait massivement appel à des campagnes de publicité et de promotion pour conserver leur part du marché. Cette situation a entraîné pour l'ensemble du secteur une rentabilité insatisfaisante, notamment pour Petro-Canada.

D'ici la fin de la décennie, la demande de produits raffinés devrait, en règle générale, demeurer aux niveaux actuels. La croissance modeste de la demande pour certains produits sera annulée par la baisse de l'utilisation du pétrole pour le chauffage; les mazouts industriels et domestiques font en effet tous deux face à la concurrence du gaz naturel et de l'électricité. La demande d'essence devrait rester stable, tandis que celle du carburant diesel et du carburéacteur, qui est étroitement liée à la situation économique, devrait s'accroître.

Après le 1er juin 1985, la déréglementation des prix et des marchés du pétrole brut a ouvert de nouvelles perspectives à notre secteur d'activité. Les raffineurs sont désormais mieux en mesure de réduire leurs coûts en ayant accès à un plus large éventail de pétroles bruts canadiens et étrangers et de produits finis et non finis.

Pendant toute l'année 1985, Petro-Canada s'est adaptée à l'évolution de la conjoncture en diversifiant et en équilibrant ses activités dans son secteur, en améliorant ses services afin de gagner la confiance de sa clientèle et en tirant le meilleur parti de la technologie afin de réduire ses coûts et de saisir les occasions qui lui ont été offertes.

L'acquisition de Gulf : dynamisme, équilibre et perspectives nouvelles

L'acquisition, le 30 septembre 1985, de certaines parties des actifs de Gulf Canada Limitée a permis de consolider et d'équilibrer les actifs actuels de la Société dans le domaine du raffinage, du

Les prospecteurs utilisent des postes de travail interactifs informatisés pour l'interprétation de données sismiques complexes tridimensionnelles.

Sur le plateau de la Nouvelle-Écosse, les puits de délimitation Alma K-85 et Thebaud I-93 ont confirmé le succès des gisements gaziers découverts auparavant. Un nouveau puits, le North Triumph G-43, était en cours de forage à la fin de l'exercice; il a par la suite été sondé et a révélé un gisement gazier. Ces travaux d'exploration visent à accroître les réserves adjacentes à l'île de Sable où l'on pourrait mettre en valeur trois gisements de gaz naturel relatifs au chantier Venture lorsque le contexte économique le permettra. Des demandes d'exportation de gaz au nord-est des États-Unis ont été déposées auprès des organismes de réglementation au cours de l'exercice.

Dans le nord du pays, Petro-Canada a participé au projet de Bent Horn par le tranchement d'une filiale, ce qui a conduit à la première livraison d'hydrocarbures en provenance des îles de l'Arctique vers les marchés du Sud.

Dans l'ouest de l'Arctique, des travaux d'exploration intéressants se poursuivent dans la vallée et le delta du Mackenzie. Dans la vallée du Mackenzie, Petro-Canada a foré un important gisement gazier au Tweed Lake M-47. Un programme de forages supplémentaires est prévu pour le début de 1986.

Dans la péninsule de Tuktoyaktuk, Petro-Canada a participé à la découverte d'un important gisement pétrolier, au Tuk J-29. Afin d'évaluer l'ampleur et la qualité des réserves de ce gisement, certains puits de délimitation étaient en cours de forage à la fin de l'exercice; de nouveaux puits sont prévus pour le début de 1986.

Une vocation internationale

Petro-Canada a essentiellement pour mandat de découvrir et de mettre en valeur les ressources énergétiques du pays. Elle doit en même temps accroître sa participation dans certaines régions étrangères qui offrent des perspectives intéressantes en ce qui a trait aux revenus produits rapidement et au rendement des investissements. Cette stratégie lui fournit l'occasion de réaliser des bénéfices et de découvrir pour le Canada de nouvelles sources d'approvisionnement, tout en restant en contact avec la plus récente technologie, notamment dans le domaine de l'exploration en mer. Cette présence à l'étranger procure à Petro-Canada une plus grande souplesse pour s'adapter aux changements.

En 1985, la Société a continué de participer à un programme de forage au large des côtes de la Chine, même si les résultats de ce programme ont été décevants. Elle a également fait l'acquisition d'intéressantes concessions en Colombie et en Indonésie, en plus de commencer à exploiter un bloc prometteur au large des côtes de la Papouasie-Nouvelle-Guinée, où un programme d'études sismiques sera réalisé en 1986.

La participation de la Société au gisement pétrolifère de Casablanca, au large des côtes espagnoles, a continué d'être rentable. Deux nouveaux puits ont été mis en marche en 1985.

Petro-Canada met également à la disposition de la Corporation Petro-Canada pour l'assistance internationale (CPCAI) sa compétence et ses services techniques; les frais engagés par la Société lui sont remboursés au prix de revient. Filiale de Petro-Canada autonome financièrement, la CPCAI est dotée de son propre conseil d'administration et est financée par le gouvernement du Canada pour assurer une aide à l'étranger. En 1985, cette société a mené à bonne fin un certain nombre de programmes d'exploration et de mise en valeur dans des pays en voie de développement. Ses efforts ont accru le prestige du Canada et fait rayonner dans le monde entier la compétence énergétique de notre pays; ils ont également apporté des avantages commerciaux considérables au secteur pétrolier et gazier du Canada.

Superficie

au 31 décembre 1985	Brute	Nette
	(milliers d'hectares)	
Régions non éloignées		
Colombie-Britannique	1 352	692
Alberta*	3 653	1 623
Saskatchewan	192	124
Manitoba	149	76
Ontario	31	16
Régions éloignées		
Territoires du Nord-Ouest	5 790	5 240
Mer de Beaufort	3 163	456
Baie d'Hudson	429	53
Îles de l'Arctique**	6 845	954
Au large de la côte Est	14 631	7 415
Au large de la côte Ouest	2 358	2 358
À l'étranger	3 407	1 108
Total***	42 000	20 115

* y compris les concessions de sables pétrolifères prises à bail
** à l'exclusion des concessions détenues par Panarctic Oils Ltd.
*** à l'exclusion des concessions charbonnières prises à bail

Sommaire des réserves prouvées

au 31 décembre 1985	Pétrole		Liquides de gaz naturel		Gaz naturel	
	Avant redevances	Après redevances	Avant redevances	Après redevances	Avant redevances	Après redevances
	(milliers de mètres cubes)		*(milliers de mètres cubes)*		*(millions de mètres cubes)*	
Colombie-Britannique	2 890	2 244	831	672	31 423	28 103
Alberta†	39 991	29 995	6 614	4 821	66 980	49 392
Saskatchewan	2 463	1 997	–	–	419	367
Total pour le Canada	45 344	34 236	7 445	5 493	98 822	77 862
À l'étranger	478	478	–	–	–	–
Total à l'excl. du synthétique	45 822	34 714	7 445	5 493	98 822	77 862
Synthétique brut††	39 102					
Total	84 924					

† pétrole classique et sables pétrolifères in situ
†† en raison de la subjectivité qui touche la fixation des redevances pour la production de Syncrude, la Société ne présente pas ses réserves de brut synthétique nettes de redevances

L'importance des sables pétrolifères aujourd'hui et demain

Les participations de Petro-Canada dans des projets d'exploitation pétrolifère apportent à l'heure actuelle un concours appréciable aux activités de la Société. En 1985, Petro-Canada a enregistré sa première production commerciale à partir de sables pétrolifères in situ, a produit avec d'autres entreprises des volumes records de brut synthétique sur le chantier Syncrude et a continué d'étudier la possibilité d'enrichir considérablement ses moyens d'exploitation des sables pétrolifères.

En avril 1985, la production à l'échelle commerciale a été amorcée au chantier de sables pétrolifères in situ de Wolf Lake, dans le nord-est de l'Alberta. Exploité en association, ce chantier, dont Petro-Canada est actionnaire à 50 per cent, fait appel à la technologie de l'injection de vapeur pour récupérer environ 1 100 mètres cubes par jour de bitume. La première étape de ce chantier a permis la création de plus de 100 emplois permanents. À long terme, le projet de Wolf Lake pourrait être exécuté en plusieurs phases afin de satisfaire aux besoins énergétiques futurs.

En 1985, la production du chantier d'exploitation des sables pétrolifères de Syncrude a atteint un sommet sans précédent. Ce chantier, dont Petro-Canada possède 17 per cent des intérêts, est aménagé près de Fort McMurray, en Alberta. La part de Petro-Canada dans la production de brut synthétique complètement valorisé a totalisé 1,27 million de mètres cubes, soit 15 pour cent de plus que le niveau record atteint en 1983. En 1985, les travaux se sont poursuivis pour porter la capacité de cette usine à 22 000 mètres cubes par jour. Ce projet d'accroissement de la capacité représentera environ 720 millions de dollars, et la part de Petro-Canada sera de 122 millions de dollars.

En 1985, Petro-Canada a continué d'étudier la faisabilité d'un projet d'exploitation des sables pétrolifères qui serait amorcé sur les concessions de Daphné, à quelque 65 kilomètres au nord de Fort McMurray, en Alberta.

Des progrès véritables dans les régions éloignées

En 1985, un programme fructueux mettant l'accent sur les régions éloignées les plus prometteuses a donné lieu à plusieurs grandes découvertes. Celles-ci ont permit d'accroître les réserves possibles de la Société et de préciser les possibilités de mise en valeur les plus intéressantes.

Le puits Terra Nova K-07, qui suit la découverte de gisements pétroliers en 1984 par Petro-Canada au large des côtes terre-neuviennes et qui lui appartient à 75 pour cent, a été très important pour la Société. Ce puits, dont le débit cumulatif est de 1 273 mètres cubes par jour, a confirmé à la Société que ce gisement renferme des réserves importantes qui peuvent être mises en valeur. À la fin de l'exercice, un nouveau puits de délimitation a été foré à Terra Nova I-97.

Le découverte des gisements de Ben Nevis voisins de Terra Nova a également été importante. Petro-Canada détient une participation de 37,5 pour cent dans le West Ben Nevis B-75 et de 25 pour cent dans le North Ben Nevis P-93.

La Société possède 25 pour cent des intérêts dans le plus important gisement de la côte Est découvert jusqu'à maintenant, à Hibernia, au large de Terre-Neuve. En 1985, le plan de développement du projet d'Hibernia et l'étude d'impact environnemental s'y rapportant ont été déposés auprès des gouvernements fédéral et terre-neuvien. Ce plan requerra un investissement de quatre milliards de dollars avant la mise en marche des travaux au début des années '90 et il inclura l'aménagement d'une structure à embase-poids en béton pour supporter les installations de production.

Le pétrole brut synthétique produit par le projet Syncrude générera des fonds importants pour la Société. Ce projet constitue en outre un nouveau client pour les lubrifiants et les huiles légères de Petro-Canada.

Alberta; les principaux gisements ont été trouvés dans les régions de Peco, de Pembina et de West Pembina, à l'ouest d'Edmonton. En outre, Petro-Canada a continué d'accroître ses actifs en faisant l'acquisition de concessions stratégiques.

La production totale des liquides et la production de gaz naturel ont toutes deux atteint des niveaux inégalés en 1985. Il faut en particulier mentionner les augmentations marquées de la production du gaz naturel, des liquides de gaz naturel et de brut synthétique.

Petro-Canada continue d'actualiser la technologie qu'elle utilise pour soutenir ses activités. En 1985, les fonctions de recherche et de développement ont été intégrées au sein des groupes de l'exploration et de la production afin de faciliter l'application directe des résultats de la recherche et des techniques perfectionnées, de permettre une meilleure analyse des possibilités et d'accroître l'efficacité de l'exploitation.

De nouveaux projets renforcent nos activités dans l'Ouest

Une usine de traitement du gaz acide, une usine d'extraction des liquides de gaz naturel et trois chantiers de mise en valeur de champs pétrolifères ont été au nombre des investissements importants effectués au cours de l'exercice.

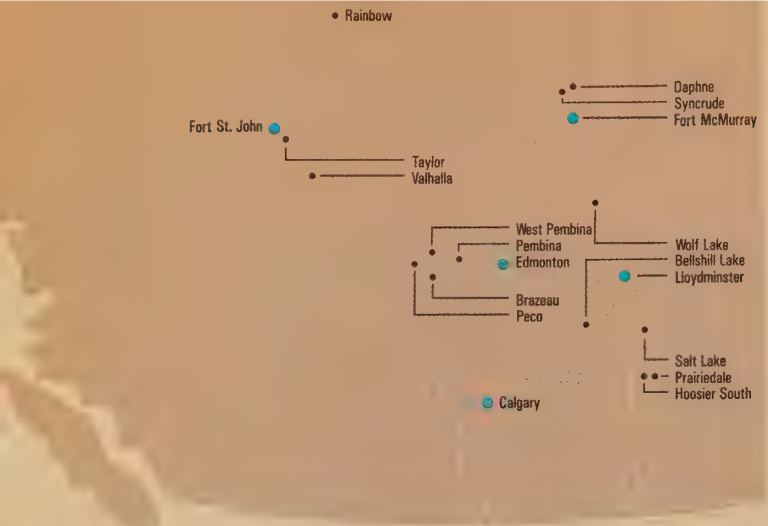
L'usine de gaz acide de Brazeau, à 160 kilomètres au sud-ouest d'Edmonton, a entrepris ses activités vers la fin de l'été. Exploitée par Petro-Canada, qui en possède 42,5 pour cent, cette installation traite environ 700 000 mètres cubes par jour de gaz pour extraire plus de 800 mètres cubes par jour de condensat et de gaz de pétrole liquéfiés, ainsi que 80 tonnes par jour de soufre. Le gaz résiduel est réinjecté dans la formation afin de maintenir la pression et d'améliorer la production des liquides de grande valeur. L'usine est dotée d'un système de commandes informatisées perfectionnées afin d'accroître au maximum l'efficacité et la rentabilité, en plus de réduire les émissions.

Petro-Canada a une participation de 50 pour cent dans une usine de liquides de gaz naturel mise en marche à la fin de 1985 à Taylor, dans le nord-est de la Colombie-Britannique. Cette usine communique avec le pipeline qui passe de Taylor à Vancouver et extrait jusqu'à 1 080 mètres cubes par jour de propane, de butane et de pentane-plus.

Ailleurs, des efforts ont été consacrés en 1985 à la mise en valeur des gisements les plus prometteurs. À Valhalla, à 60 kilomètres au nord-ouest de Grande-Prairie en Alberta, Petro-Canada a lancé un programme de récupération améliorée par injection d'eau pour le gisement pétrolifère qu'elle y a découvert en 1981. Ce chantier a fait passer les réserves prouvées de brut léger de grande qualité de 1,2 à 4,8 millions de mètres cubes.

À Salt Lake, en Saskatchewan, les travaux de mise en valeur ont progressé rapidement après le forage, en septembre 1984, du puits de découverte de Petro-Canada. Cinq puits de pétrole étaient en service à la fin de 1984. À la clôture de l'exercice 1985, 46 puits produisaient 340 mètres cubes par jour de pétrole brut.

À Bellshill Lake, dans le centre-est albertain, un programme d'optimisation de la production pétrolière a été mené à terme. Quarante-neuf nouveaux puits ont été forés, ce qui a accéléré le rythme de la production pétrolière dans l'un des principaux gisements de Petro-Canada.

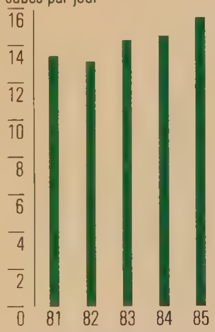


Activités dans l'Ouest canadien

La nouvelle usine de production de gaz acide de Brazeau River produit des condensats, des gaz de pétrole liquéfiés et du soufre de qualité.

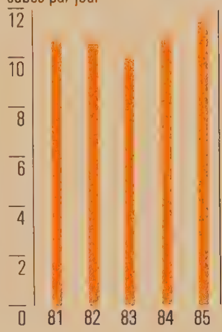
À Bellshill Lake, l'un des principaux gisements de pétrole de Petro-Canada, les volumes de production ont été améliorés grâce au forage de 49 nouveaux puits.

Niveau record obtenu dans la production brute de pétrole brut et de liquides de gaz naturel*



* à l'exclusion des liquides de gaz naturel des usines de récupération

La production brute de gaz naturel a atteint un niveau record



Sommaire de la production*

pour l'exercice terminé le 31 décembre 1985	Pétrole *(milliers de mètres cubes)*	Liquides de gaz naturel *(milliers de mètres cubes)*	Gaz naturel *(millions de mètres cubes)*
Alberta	4 447	1 546	2 810
Pétrole classique	3 179	609	2 810
Syncrude	1 268	–	–
Empress	–	937	–
Colombie-Britannique	228	45	1 404
Classique	228	31	1 404
Taylor	–	14	–
Saskatchewan	235	–	10
Manitoba	3	–	–
Total pour le Canada	4 913	1 591	4 224
À l'étranger	134	–	–
Total	5 047	1 591	4 224

* Part de la Société avant les redevances

Division Ressources – Points saillants

L'exercice 1985 a été fructueux pour les Ressources Petro-Canada. Cette division a réalisé des résultats d'exploitation satisfaisants en diversifiant ses rentrées de fonds, en mettant rapidement en service de nouvelles installations dans l'ouest du pays et en allant de l'avant avec les projets à long terme de façon constante, mais prudente. Ces activités qui sont conformes à la stratégie d'ensemble de la Société s'inscrivent dans le cadre des efforts déployés par les Ressources Petro-Canada afin d'assurer le maintien de la rentabilité.

Les résultats d'exploitation ont été particulièrement satisfaisants, surtout si l'on tient compte de l'évolution de la situation dans notre secteur au cours de l'année. Le prix du pétrole a été à la fois en baisse et imprévisible, ce qui a fait hésiter de nombreuses entreprises à se lancer dans des projets à long terme. Les contraintes imposées par la capacité des pipelines ont fait cesser la production pétrolière, tandis que les prix du gaz naturel pour l'exportation ont énormément baissé. En revanche, l'Accord de l'Ouest et l'Accord Atlantique, la déréglementation du brut canadien après le 1er juin, l'allégement des contrôles imposés sur la commercialisation du gaz naturel et les nouvelles mesures incitatives dans les provinces productrices ont créé, à la fin de l'exercice, un climat plus favorable pour notre secteur d'activité.

L'année la plus active pour Petro-Canada dans l'Ouest

Les activités de la Société dans l'ouest du pays constituent, pour les Ressources, des assises à la fois fortes et diversifiées. En 1985, Petro-Canada a concentré son activité sur les secteurs les plus prometteurs, en mettant l'accent sur la possibilité de produire rapidement des revenus et d'assurer la rentabilité.

Petro-Canada a participé au forage de 166 puits d'exploration, qui ont produit 52 puits de pétrole et 51 de gaz; 63 puits stériles ont été abandonnés. En hausse par rapport à l'an dernier, ce taux de réussite à 62 pour cent a été réalisé en engageant des frais de recherche concurrentiels. Sur un nombre net de 565 puits de développement, 518 ont été des puits de pétrole ou de gaz fructueux, soit un taux de réussite de 92 pour cent. Les gisements découverts à Prairiedale, à Salt Lake et à Hoosier South, dans l'ouest de la Saskatchewan, ainsi que dans la région de Rainbow, dans le nord-ouest albertain, ont enrichi considérablement les réserves pétrolières. Des gisements de gaz ont été découverts en Colombie-Britannique et en

Les cliniques d'entretien de l'auto pour les femmes représentent sûrement pour les détaillants une excellente façon de participer aux activités de la communauté.

L'évaluation de l'efficacité de chaque division a donné lieu à des restructurations. Au sein des Produits Petro-Canada, les fonctions de base telles que le contrôle, la planification et l'ingénierie ont été consolidées afin de permettre une meilleure exploitation des trois unités régionales dotées d'une responsabilité financière. Dans ce contexte et pour assurer de meilleures communications au niveau des cadres, il a été décidé de déplacer quelque 250 postes de Toronto à Calgary en 1986. Des modifications de structure ont été apportées aux Ressources Petro-Canada, afin d'adapter cette division aux nouvelles tendances économiques et d'offrir aux membres du personnel de meilleurs horizons professionnels.

En ce qui concerne la prévention, la Société participe au système international d'évaluation. Elle a obtenu en 1985 une excellente cote grâce à sa méthode rigoureuse de définition des normes de prévention et à son rendement en matière de vérification de ces normes.

Participation au sein de la collectivité
Petro-Canada conserve la ferme volonté de veiller à ce que ses activités commerciales aient des retombées favorables pour le Canada et les Canadiens, notamment dans les régions où elle est très présente. L'accroissement des perspectives d'emploi et des occasions d'affaires pour les Canadiens entre toujours en ligne de compte dans les décisions de la Société en matière d'investissements.

En 1985, le programme d'exploration de Petro-Canada dans la vallée du Mackenzie a entraîné des retombées économiques importantes pour les gens du Nord. Plus de la moitié des membres des équipes de forage et d'études sismiques ont été recrutés parmi les habitants de la localité, et plus de 60 entreprises de la région ont fourni des biens et services, notamment en louant des camps, en assurant le déblaiement des terrains et le transport, en vendant des pièces détachées et en offrant des services de réparation et d'entretien et du matériel lourd.

Les travaux d'exploration de Petro-Canada dans les régions éloignées ont créé d'importants débouchés pour les entreprises régionales qui fournissent des biens et des matériaux reliés à l'exploration. En outre, l'Université de Dalhousie et la Memorial University, dans les provinces de l'Atlantique, ont reçu des fonds pour mettre en oeuvre deux nouveaux programmes de recherche et de formation dans le domaine des sciences de l'exploitation pétrolière en mer. Une aide a également été apportée à d'autres établissements d'enseignement afin de permettre aux Canadiens d'apprendre des métiers très spécialisés reliés aux activités d'exploration en mer.

Au cours de l'exercice, Petro-Canada a continué de jouer, par le biais de parrainages et de dons, un rôle au sein des collectivités où la Société et ses employés exercent leurs activités. La participation de Petro-Canada à la campagne Centraide (United Way) a été cette fois encore exceptionnelle. Les cotisations versées par les employés et le montant correspondant offert par la Société ont ensemble représenté le don le plus important jamais versé à la campagne United Way à Calgary. Dans le cadre de l'Année internationale de la jeunesse, certaines activités, notamment le parrainage d'équipes de soccer et de baseball par des détaillants, ont fait l'objet d'une attention particulière. Le fonds du Manoir Ronald McDonald et la Fondation Bluenose II ont été parmi les causes appuyées par la clientèle de Petro-Canada à l'occasion de campagnes de promotion très originales.

Petro-Canada a augmenté l'étendue et la qualité de ses services pour ses clients. De nouvelles brosses de tissu sont présentement mises à l'essai dans certains lave-autos.

mer de Beaufort, dans les îles de l'Arctique et au large des côtes du Labrador, de Terre-Neuve et de la Nouvelle-Écosse. Petro-Canada continuera de jouer un rôle considérable dans ces régions dans l'évaluation de la viabilité tant du point de vue financier que de l'exploitation technique des réserves découvertes et dans la recherche de nouveaux débouchés commerciaux.

L'acquisition de Gulf : l'investissement le plus important de l'exercice
L'investissement le plus important de 1985 est l'acquisition, par Petro-Canada, des activités d'aval de Gulf Canada Limitée en Ontario, dans l'ouest du Canada, au Yukon et dans les Territoires du Nord-Ouest. Aux termes de l'accord conclu le 30 septembre 1985, Petro-Canada a fait l'acquisition, au prix de 611 millions de dollars, des actifs de raffinage, de transport et de commercialisation ainsi que du fonds de roulement de cette société. Cette acquisition a été financée à même les ressources internes et des emprunts ordinaires. Selon cet accord, Petro-Canada se portera acquéreur au début de 1986 de la raffinerie de Gulf à Edmonton pour une somme de 275 millions de dollars.

Ces installations supplémentaires de raffinage et de commercialisation viennent compléter les activités actuelles de la Société et améliorent sa situation vis-à-vis de la concurrence, partout au pays, notamment dans l'Ouest. En occupant une place importante dans le secteur des produits raffinés, Petro-Canada pourra accroître son efficacité et fournir à ses clients un ensemble complet de services de qualité. Si l'on ajoute ces nouveaux éléments aux travaux d'exploration et de production, la Société se retrouve dans une excellente position. Si, comme prévu, le contexte économique continue d'être marqué par l'incertitude, Petro-Canada pourra continuer à saisir des occasions intéressantes, dans les deux secteurs d'activité à la fois.

Une entreprise solide
Pendant tout l'exercice 1985, les stratégies commerciales et financières de la direction en matière de positionnement ont été empreintes d'un souci aigu des questions relatives au perfectionnement des employés, à l'efficacité administrative et à la sécurité du personnel.

En plus de la planification permanente du perfectionnement des employés, un programme de perfectionnement des cadres a été mis en oeuvre. Un comité spécial s'occupe de la planification de la relève parmi les cadres et les membres de la haute direction offrant les meilleures possibilités.

Petro-Canada a connu un exercice vigoureux et fructueux dans le domaine de l'exploration sur la côte Est du Canada.

Ressources énergétiques futures

Petro-Canada – Points saillants

Les résultats financiers de Petro-Canada pour 1985 rapportent des fonds autogénérés de 906 millions de dollars et un bénéfice avant éléments inhabituels et dividendes de 174 millions de dollars. Ces résultats, quelque peu inférieurs aux niveaux records inscrits pour 1984, sont surtout la conséquence des prix plus bas qui ont marqué la situation fortement concurrentielle en 1985.

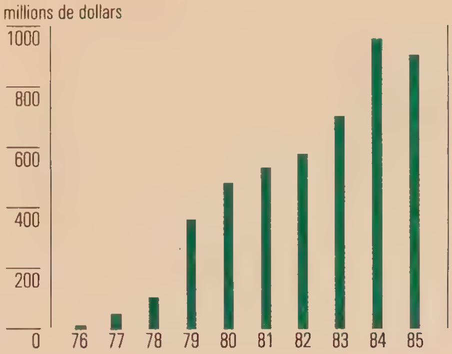
Diminution de la valeur comptable de certains actifs en raison de l'accent sur la rentabilité

Les bénéfices de Petro-Canada en 1985 ont été réduits de 865 millions de dollars après impôts, en raison de frais inhabituels constitués essentiellement de radiations de la valeur comptable de certains actifs dans les régions éloignées. Cette mesure a été prise à la suite d'une réévaluation de l'ensemble de nos investissements, en tenant compte de la baisse du prix mondial du pétrole et de l'orientation commerciale de la Société.

Au cours des dernières années, la teneur des activités de Petro-Canada dans les régions éloignées a évolué. En vertu de son mandat initial, la Société affectait ses investissements à l'inventaire des ressources dans les régions éloignées et à l'évaluation des coûts probables de leur mise en valeur. Les succès de ces premiers travaux ainsi que la baisse de la demande énergétique et du prix mondial du pétrole ont donné aux Canadiens une évaluation raisonnable de l'ampleur des réserves d'hydrocarbures du pays et une indication des réserves qui pouvaient être mises en valeur de façon rentable. Petro-Canada axe aujourd'hui ses efforts sur l'exploitation commerciale des projets qui offrent, à court et à moyen termes, des possibilités de rendement. La Société a donc radié certaines propriétés dans les régions éloignées dont l'exploitation n'est pas rentable, dans la situation actuelle. Elle a en outre constitué une provision pour certaines pertes prévues sur des navires de forage en mer et sur du matériel auxiliaire loués par contrat.

Si l'intérêt des régions éloignées est limité à l'heure actuelle, de nombreux gisements découverts offrent, à long terme, des perspectives de mise en valeur. Les Canadiens peuvent désormais éprouver le sentiment de sécurité que donne une meilleure connaissance des réserves énergétiques du pays. Les ressources qui pourraient être mises en valeur éventuellement comprennent de nouveaux dépôts de sables pétrolifères dans l'ouest du Canada, ainsi que des gisements de pétrole et de gaz dans la vallée et le delta du Mackenzie, dans la

Croissance remarquable des fonds autogénérés de Petro-Canada



a été enthousiaste et les ventes de produits pétroliers se sont accrues. En faisant l'acquisition de certaines tranches de BP Canada Inc. en 1983 et de Gulf Canada Limitée en 1985, la Société a constitué un réseau national qui lui permet de servir parfaitement ses clients dans toutes les régions. L'image canadienne de Petro-Canada continue de représenter un élément essentiel de la réussite de la Société dans le raffinage et la commercialisation.

Appui accordé aux détaillants et aux agents, à titre d'hommes et de femmes d'affaires indépendants

La Société a constaté que le service à la clientèle est essentiel à la réussite de ses activités à long terme dans le domaine de la commercialisation des produits raffinés. C'est pourquoi elle est déterminée à appuyer ses détaillants et ses agents, à titre d'hommes et de femmes d'affaires indépendants, qui entretiennent des liens étroits avec leur collectivité. L'inscription du nom du détaillant sur les enseignes de tous les postes de vente est un exemple de cet engagement. Petro-Canada encourage également ses détaillants à participer aux activités de leurs collectivités. De nombreux établissements qui appartenaient à la Société ont même été vendus ou loués à bail à des exploitants. Grâce à toutes ces mesures, Petro-Canada s'est bâti une solide réputation dans le domaine du service à la clientèle.

La rationalisation, gage d'efficacité et de rentabilité

Au début des années 1980, les premiers indices d'un climat économique plus difficile se sont manifestés dans le secteur du pétrole et du gaz. Petro-Canada a réagi à ces premiers symptômes en amorçant une restructuration complète de ses activités, pour les rationaliser selon des objectifs rigoureux. Il en a résulté une entreprise plus rigoureusement structurée, qui gérait ses activités avec efficacité. À la fin de 1984, les résultats d'une évaluation de Petro-Canada effectuée par une société de placements nationale indiquait que la Société jouait un rôle important dans son secteur d'activité et qu'elle n'avait pas de personnel excédentaire comparativement aux sociétés concurrentes intégrées.

Importance des résultats financiers

Le mandat initial de la Société l'a amenée à effectuer des travaux d'exploration et d'autres activités dans les régions éloignées dans l'intérêt du pays. En 1984, un inventaire complet des réserves dans les régions éloignées était achevé. En raison de l'évolution de la situation économique, il est devenu évident pour Petro-Canada et son actionnaire qu'il fallait se concentrer davantage sur les activités commerciales, en mettant plus l'accent sur les résultats financiers et en laissant les importants travaux d'exploration pour passer à la mise en valeur de ressources viables et rentables. Le nouveau gouvernement fédéral élu en septembre 1984 a également précisé que Petro-Canada devait exercer son activité comme une société du secteur privé. S'étant assuré une présence marquée dans tous les secteurs clés de son industrie, Petro-Canada poursuit son évolution avec prudence, en évaluant les possibilités qui s'offrent à elle selon de solides principes commerciaux et en s'adaptant efficacement à l'évolution du marché.

Dix années décisives

En dix années à peine, soit depuis le jour où trois employés travaillaient à sa formation dans une chambre d'hôtel de Calgary, Petro-Canada a accompli d'énormes progrès. Elle est aujourd'hui l'une des plus grandes sociétés canadiennes et joue un rôle prépondérant dans tous les aspects du secteur pétrolier et gazier. C'est en raison des décisions cruciales prises aux étapes déterminantes de son évolution que Petro-Canada a pu atteindre la place prépondérante qu'elle occupe aujourd'hui.

L'ouest canadien : une source de rentabilité

L'exploration au large des côtes et dans l'Arctique et l'exploitation des sables pétrolifères étaient prioritaires pour Petro-Canada. Mais pour assurer le succès de ces entreprises à long terme, il fallait également compter sur des rentrées de fonds et une expérience d'exploitation que seules pourraient apporter de solides assises dans le secteur de l'exploration et de la production dans l'ouest du pays. Voilà pourquoi la Société a fait l'acquisition de Atlantic Richfield Canada Ltd. en 1976, de Pacific Petroleums Ltd. en 1979 et de Petrofina Canada Inc. en 1981. Grâce à ces éléments d'actif et à cette compétence, Petro-Canada a élaboré des programmes dynamiques d'exploration et de mise en valeur qui ont constitué une source de financement soutenue.

Intensification de l'exploration dans les régions éloignées

Initialement, l'orientation de Petro-Canada avait été dictée par des préoccupations d'ordre national soulevées par la crise énergétique des années 1970. Les Canadiens voulaient être assurés de nouvelles sources d'énergie. À l'époque, l'exploration dans les régions éloignées, soit dans l'Arctique et au large des côtes, avait connu peu de succès, et les entreprises qui s'en occupaient ralentissaient leurs efforts. Petro-Canada a accéléré le rythme des travaux dans les régions éloignées en investissant dans certains programmes d'exploration importants. Pour faire progresser le savoir-faire canadien dans l'exploration au large des côtes, Petro-Canada a mis en marche un programme de forages au large du Labrador, puis a amorcé ses propres activités d'exploration au large des côtes de la Nouvelle-Écosse et de Terre-Neuve. Les efforts déployés par la Société pour accélérer l'exploration ont conduit à la découverte de gisements comme Terra Nova, Hibernia et Venture.

Une position de force dans les sables pétrolifères

Afin de créer de nouvelles réserves d'énergie pour les Canadiens, il fallait travailler à l'exploitation d'une autre source énergétique importante : les sables pétrolifères de l'ouest canadien. En 1976, Petro-Canada a acquis dix-sept pour cent des intérêts dans le projet des sables pétrolifères de Syncrude, en prenant le contrôle de la part du gouvernement fédéral dans ce projet et en achetant plus tard une nouvelle part de cinq pour cent à la suite de l'acquisition de Petrofina. La Société a également fait l'acquisition de concessions valables grâce à l'achat d'Atlantic Richfield, de Pacific et de Petrofina. Depuis, Petro-Canada joue un rôle actif dans la mise en valeur des sables pétrolifères exploitables à ciel ouvert et in situ.

Une image canadienne dans la commercialisation

Ces premières acquisitions ont permis à Petro-Canada d'accéder au secteur du raffinage et de la commercialisation. En misant sur les occasions qui lui étaient offertes, Petro-Canada a redésigné ses stations-service en utilisant le symbole de la feuille d'érable et a mis l'accent, dans ses communications, sur son image et son orientation authentiquement canadiennes. La réaction des gens

Ainsi, la Société pourra conserver de solides assises financières, conformément au principe du gouvernement fédéral selon lequel elle doit exercer son activité comme une société du secteur privé. Les projets d'investissements de la Société doivent respecter les normes financières de prudence dans toutes les conditions économiques possibles.

La Société est d'avis que l'expansion de son exploitation nécessitera de nouveaux apports en capitaux propres. Afin de définir la meilleure méthode pour réunir ces capitaux nouveaux, le Conseil d'administration a constitué un comité spécial. Nous sommes heureux que le gouvernement fédéral examine activement une proposition en vue d'une émission publique d'actions.

Si la commercialisation des réserves dans les régions éloignées est importante pour la Société, la diminution actuelle du prix mondial du pétrole crée le l'incertitude quant au rythme et à 'étendue de leur mise en valeur. Étant lonné le nouveau contexte et les efforts consacrés par la Société aux projets offrant des perspectives à court terme, il st maintenant évident que certains chantiers dans les régions éloignées ne pourront être mis en valeur dans un venir prévisible. En 1985, la Société inscrit des frais inhabituels en déduction des bénéfices de 865 millions de lollars après impôts, la plupart de ces rais se composaient de réductions de aleur qui tenaient compte de ces circonstances.

Pour ce qui est du rendement de Petro-Canada en 1985, nous devons souligner plusieurs réalisations.

À la fin de septembre, Petro-Canada conclu avec Gulf Canada Limitée un ccord pour l'achat des éléments d'actif de raffinage, de transport et de commercialisation de cette société à l'ouest du Québec. Cette acquisition a fait de la Société un chef de file dans le secteur de la mise en marché des produits pétroliers dans chaque région du pays et elle devrait également lui permettre de réaliser des bénéfices importants lorsque le climat économique se sera amélioré.

Dans l'ouest du Canada, où la production du brut et du gaz naturel assure l'essentiel de la marge d'autofinancement de la Société, l'activité est demeurée soutenue en 1985 et on a commencé à exploiter plusieurs nouveaux gisements. Pendant la dernière année, trois grands projets de construction ont été achevés et les activités y ont été amorcées; il s'agit du chantier de sables pétrolifères in situ de Wolf Lake, de l'usine de traitement de gaz acide de Brazeau et de l'usine de liquides de gaz naturel de Taylor.

Petro-Canada a accompli de nouveaux progrès dans l'exploration pétrolière au large de la côte Est. Le puits foré pour la délimitation du gisement pétrolier Terra Nova, découvert en 1984 par Petro-Canada, a donné des résultats très encourageants au moment du sondage. La Société a également annoncé la découverte d'un gisement de pétrole à son puits de West Ben Nevis et a participé, plus tard au cours de l'exercice, à la découverte du gisement pétrolier voisin de North Ben Nevis.

Cette année, marquée par la croissance et l'adaptation, a été rendue plus facile grâce aux efforts déployés par tous les employés de Petro-Canada. Ceux-ci ont fait sans cesse preuve de compétence et de dévouement. Les membres du nouveau Conseil d'administration de la Société ont assuré la direction de l'entreprise avec efficacité grâce à leurs antécédents dans divers domaines et à leur connaissance des régions. Nous tenons à remercier en particulier M. Paul Tellier pour les cinq années et plus de loyaux services au Conseil pendant qu'il était sous-ministre aux Affaires indiennes et du Nord et auprès du ministère de l'Énergie, des Mines et des Ressources. M. Tellier a quitté ses fonctions au Conseil en 1985, après avoir été nommé greffier du Conseil privé.

Enfin, nous admettons que la fidélité des Canadiens reste essentielle à notre réussite. Les consommateurs du pays ont montré qu'ils sont favorables à notre présence sur le marché canadien. Ils ont accueilli avec enthousiasme l'occasion d'appuyer la Société dans son mandat qui vise à mettre en valeur le secteur énergétique du pays. Au cours de ces dix années, nous avons puisé notre dynamisme dans cette confiance.

Le président du Conseil et
directeur général,

W. H. Hopper

Le 31 mars 1986

Message du président du Conseil

Petro-Canada vient de connaître dix années importantes, au cours desquelles les défis, les changements et les occasions ont été remarquables dans notre secteur d'activité. Tant au Canada qu'à l'étranger, les tendances économiques, politiques et sociales ont obligé les entreprises du secteur pétrolier et gazier à modifier leur orientation et à envisager la réalité dans d'autres perspectives. Les entreprises qui ont réussi ont été celles qui ont su saisir rapidement les nouvelles occasions. Au cours des prochaines années, cette capacité d'adaptation demeurera une condition essentielle à la réussite.

Pour Petro-Canada, l'exercice 1985 s'est déroulé sous le signe de l'adaptation aux changements. Du point de vue financier, les bénéfices ont été modestes, comme prévu, même si la Société a continué d'assurer une marge d'autofinancement considérable. Petro-Canada a en outre versé, sur ses actions ordinaires, son premier dividende au gouvernement du Canada. La restructuration de l'ensemble des éléments d'actif a compté parmi les plus grandes réalisations de l'exercice de la Société. Grâce à ces mesures, Petro-Canada est désormais dotée de la souplesse, de l'envergure et de l'équilibre nécessaires à son succès, quels que soient les défis de l'avenir.

En 1985, notre secteur a été aux prises avec un contexte économique à la fois incertain et difficile. L'excédent de l'offre sur la demande sur les marchés pétroliers mondiaux a donné lieu à un repli général et imprévu du prix du brut. Cette conjoncture mondiale s'est répercutée sur le secteur pétrolier et gazier au Canada, qui est en train de s'adapter à la faible demande et à l'irrégularité des prix du brut, du gaz naturel et des produits pétroliers raffinés.

Dans les domaines de l'exploration et de la production, l'exploitation du pétrole classique dans l'ouest du Canada a pu résister dans le passé à ces pressions négatives du marché, mais il est peu probable que les niveaux présents d'activité puissent être maintenus. La viabilité de ces chantiers et le moment où ils seront mis en oeuvre, facteurs qui joueront un rôle déterminant pour augmenter les réserves du Canada à long terme, dépendront du prix mondial du brut et des accords fiscaux conclus avec les gouvernements.

Dans les domaines du raffinage et de la commercialisation, la rentabilité a été limitée par la surcapacité. Des modifications devront être apportées pour assurer des rendements suffisants et pour soutenir les investissements nécessaires au maintien des services demandés par le grand public.

La léthargie du contexte économique a été compensée, d'une certaine façon, par les mesures adoptées par les gouvernements fédéral et provinciaux. En raison de la déréglementation dans le secteur du pétrole et du gaz naturel, les forces du marché peuvent de plus en plus s'exercer, ce qui incite l'industrie à découvrir de nouveaux moyens d'améliorer la sécurité énergétique du pays.

Les accords passés entre le fédéral et les provinces ont créé un climat de compréhension grâce auquel notre secteur peut exercer ses activités avec une plus grande confiance. Dans l'Ouest, les gouvernements provinciaux ont remanié leurs principes en matière de redevances et d'encouragements fiscaux, afin de favoriser les travaux d'exploration et de mise en valeur. En outre, l'annonce d'une nouvelle politique énergétique dans les régions éloignées laisse entrevoir une rationalisation des règlements sur les terres du Canada et la définition de conditions non discriminatoires, qui tiennent compte de la rentabilité.

Petro-Canada comprend parfaitement les répercussions produites par ce contexte. Afin de contenir dans des limites acceptables l'ensemble de ses risques commerciaux et financiers, la Société continue de diversifier ses éléments d'actif et d'améliorer l'équilibre entre ses investissements à court et à long termes. Grâce à une présence à la fois dynamique et grandissante dans l'ouest du pays, Petro-Canada pourra compter en permanence sur une marge d'autofinancement importante. Cette marge permettra à la Société de poursuivre dans les régions éloignées des travaux comportant plus de risques et nécessitant de longs délais d'exécution.

Pendant la majeure partie des dix années écoulées, la Société a été l'un des chefs de file en ce qui a trait aux activités dans les régions éloignées. Dans la mesure où la mise en valeur des ressources sera rentable, Petro-Canada poursuivra ses travaux d'exploitation du pétrole au large de la côte Est, des sables pétrolifères et du pétrole lourd dans les régions qui offrent les perspectives les plus intéressantes.

;onseil d'administration

'ilbert (Bill) H. Hopper
résident du Conseil
administration
directeur général
etro-Canada
ılgary (Alberta)

lward M. Lakusta
résident et chef de
exploitation
etro-Canada
ılgary (Alberta)

obin Abercrombie
xpert-conseil
ılhalla Energy Corporation
ıncouver
olombie-Britannique)

fred E. Barroll
pert-conseil
E. Barroll Resource
nsultants Ltd.
lgary (Alberta)

an Bazin, C.R.
socié principal
ers, Casgrain
ocats et procureurs
ontréal (Québec)

ıdolph Bratty, C.R.
socié principal
atty and Partners
ocats et procureurs
wnsview (Ontario)

y Victor Deyell, C.R.
socié principal
Laws and Company
ocats et procureurs
gary (Alberta)

Anne R. Dubin, C.R.
Associée principale
Tory, Tory, DesLauriers
and Binnington
Avocats et procureurs
Toronto (Ontario)

*† **William McBurney Elliott, C.R.**
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MacPherson, Leslie and Tyerman
Avocats et procureurs
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* **John Lundrigan**
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† **H. Harrison McCain**
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d'administration
McCain Foods Limited
Florenceville
(Nouveau-Brunswick)

* **Jocelyne Pelchat**
Vice-présidente des quotidiens
Quebecor Inc.
Montréal (Québec)

† **David Read**
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Les Restaurants
McDonald's Ltée
Dartmouth (Nouvelle-Écosse)

James Robertson
Homme d'affaires
Mack Travel Ltd.
Inuvik
(Territoires du Nord-Ouest)

† **Paul M. Tellier**
Sous-ministre
Énergie, Mines et Ressources
Ottawa (Ontario)
(a démissionné le 12 août 1985)

* Membre du Comité de
vérification
† Membre du Comité de
direction

Direction

Wilbert (Bill) H. Hopper
Président du Conseil
d'administration
et directeur général

Edward M. Lakusta
Président
et chef de l'exploitation

David P. O'Brien
Vice-président à la direction

Robert J. Mayo
Président
Produits Petro-Canada

James M. Stanford
Président
Ressources Petro-Canada

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Calgary (Alberta) T2P 3E3
Téléphone : (403) 296-8000
Télex : 03825753

Le 31 mars 1986

L'honorable Pat Carney, C.P., député
Ministre de l'Énergie, des Mines et des Ressources
Chambre des Communes
Ottawa, Canada

Madame le Ministre,

Nous avons l'honneur de vous présenter, au nom du Conseil d'administration, le rapport annuel de Petro-Canada pour l'exercice terminé le 31 décembre 1985.

Conformément aux dispositions de la Loi sur l'administration financière, ce rapport comprend les états financiers consolidés de la Société, ainsi que le rapport des vérificateurs.

Veuillez agréer, Madame le Ministre, l'assurance de notre très haute considération.

Le président du Conseil
d'administration et
directeur général,

W. H. Hopper

Table des matières

La Société

Créée en 1975 en vertu d'une loi du Parlement, Petro-Canada appartient en totalité au gouvernement du Canada. La Société a commencé ses activités le 1er janvier 1976. Celles-ci comprennent essentiellement l'exploration et la production du pétrole et du gaz, ainsi que le transport, le raffinage et la distribution d'hydrocarbures, de façon à répondre aux besoins des Canadiens.

Principale société du secteur pétrolier appartenant à des intérêts canadiens, Petro-Canada est la seule entreprise pétrolière et gazière canadienne qui possède un réseau de commercialisation à l'échelle nationale. À la clôture de l'exercice 1985, son actif s'élevait à 8,8 milliards de dollars et elle employait 10 565 personnes. La Société se classe parmi les cinq premières entreprises, selon toutes les normes d'exploitation généralement utilisées, dans les domaines de l'exploration et de la production; elle occupe l'une des premières places au pays pour le raffinage et la commercialisation de produits pétroliers.

Rapport annuel 1985

Petro-Canada

1986

Annual

Report

Corporate Profile

Petro-Canada, formed by an Act of Parliament in 1975, is wholly owned by the Government of Canada. Operations began on January 1, 1976. The Corporation is primarily engaged in oil and gas exploration and production, and the transportation, refining and marketing of hydrocarbons for Canadian needs.

Petro-Canada is the largest Canadian-owned company in the petroleum industry and the only Canadian-owned oil and gas company with a national marketing network. With assets in excess of $8 billion, the Corporation ranks among the top five companies in all commonly used operating measures in exploration and production, and is one of the nation's largest refiners and marketers of petroleum products.

Contents

Consolidated Financial and Operating Highlights

March 23, 1987

The Honourable Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

Dear Minister:
On behalf of the Board of Directors, I am pleased to present Petro-Canada's Annual Report for the fiscal year ended December 31, 1986.

In accordance with the provisions of the Financial Administration Act, the Report includes the consolidated financial statements together with the auditors' report thereon.

Yours sincerely,

W.H. Hopper
Chairman of the Board
and Chief Executive Officer

Financial	1986	1985
Earnings after dividends on redeemable preferred shares (millions of dollars)	123	96*
Internally generated cash from operations (millions of dollars)	770	906
Capital expenditures (millions of dollars)		
Property, plant and equipment, net of incentives	448	710
Acquisitions including minority interests	301	1010

*before unusual items

Operating	1986	1985
Crude oil and field natural gas liquids production, net before royalties (thousands of m^3 per day)	16.3	15.7
Natural gas production, net before royalties (millions of m^3 per day)	10.2	11.6
Natural gas liquids production from straddle plants (thousands of m^3 per day)	2.6	2.6
Crude oil processed by Petro-Canada (thousands of m^3 per day)	47.2	34.2
Petroleum product sales (thousands of m^3 per day)	44.3	35.5

Chairman's Message

The past year was a time of crisis for the world's oil industry, and Canadian companies were no exception. In 1986, average crude oil prices were approximately 45 per cent below 1985 levels; small increases towards year end were encouraging but prices remained volatile. Few industries, particularly of the magnitude of Canada's oil and gas business, have had to adapt to such a drastic cut in the price of their primary product.

The past year was a time of crisis for the world's oil industry.

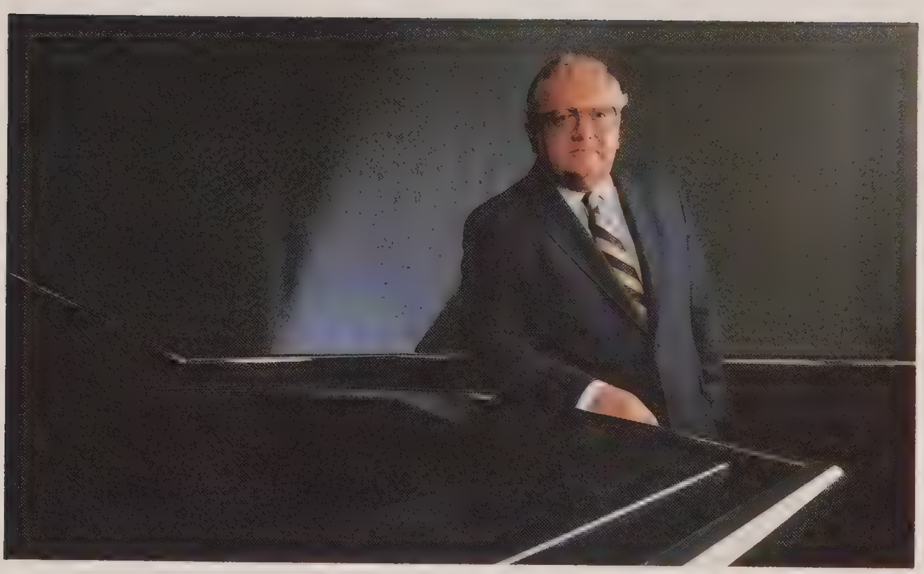
The price slide severely tested Petro-Canada's financial health and its entrepreneurial spirit, making it the most critical year yet for the Corporation. However, I am pleased to report that 1986 was a year in which good ideas became creative solutions, and the Corporation was sufficiently strong and diversified to weather the storm.

Petro-Canada was sufficiently strong and diversified to weather the storm.

Petro-Canada's performance in this exceptionally difficult year signals the successful transition from a policy-guided to a commercially driven company. While in the past Petro-Canada was directed to invest aggressively in Canada's frontier areas, its activities and expenditures are now geared to enhancing the Corporation's already substantial financial health and operating capability. This has required a greater focus on short-term cash generation, as well as a continued position in the most promising energy development projects, thereby providing the potential for dynamic growth in the future.

During 1986, Petro-Canada, in common with the rest of the industry, was forced to re-evaluate all of its operations in light of the new business environment. The need to concentrate on short-term cash generation meant that tough decisions had to be made quickly, with the primary emphasis on developing cost savings and efficiencies to improve margins. In the upstream division, costs were reduced through a concerted re-examination of all oilfield operations and procedures. In the downstream, marketing facilities were rationalized, making assets more productive. Realignment and centralization reduced staff levels in all divisions in order to further cut costs and improve productivity. While many of these measures were difficult to implement, and only possible through the hard work and understanding of Petro-Canada's staff, the Corporation has gained fundamental efficiencies that will have enduring benefit.

Petro-Canada's emphasis on its immediate financial strength has not precluded attention to the Corporation's long-term needs. We are continuing our activity in



Canada's offshore and oil sands areas, albeit at a reduced level, and will participate in the development of these substantial reserves when they become commercially feasible. Petro-Canada expects oil prices to remain volatile in the foreseeable future, so that financial risks will continue to be high for new frontier projects. As a result, it is likely that Canadian consumers will rely increasingly on imported oil over the coming years. This is a fundamental issue facing Canada. It is up to governments to decide whether they will provide the financial assistance necessary for industry to develop higher-cost domestic reserves and displace at least some of these imports, thereby lessening Canada's vulnerability to interruptions or rising costs of imported supply.

Specific financial results for 1986 were encouraging despite the difficult economic climate. Earnings were $123 million. Internally generated cash from operations was healthy at $770 million and sufficient to carry out an appropriate level of activity for current opportunities, as well as to keep debt manageable. When it becomes feasible for Petro-Canada to participate in major new frontier and oil sands developments, the Corporation will require considerable additional external financing in a judicious mix of debt and equity.

The Corporation has gained fundamental efficiencies that will have enduring benefit

The year's results reflect the strengthening of Petro-Canada's downstream division over the last few years. The acquisition and integration of downstream operations from BP Canada Inc. in 1983 and Gulf Canada Limited in 1985 and 1986

Financial results for 1986 were encouraging despite the difficult economic climate.

have enabled us to develop a large and competitive petroleum products business, with significant refining and marketing operations from coast to coast. The contribution from downstream operations improved in the second half of 1986, as it did for our competitors, but profitability and returns on investment remain modest. However, this improvement was significant for the Corporation, allowing it to maintain a satisfactory level of investment despite the world oil price slide and the consequent reduction in upstream cash flow.

Operating highlights in 1986 included the addition of the modern, efficient Edmonton refinery and the integration of the other former Gulf operations within a carefully considered strategy to optimize returns. In the upstream, exploration was increasingly focused on Western Canada conventional fields, and production was held at historically high levels despite cuts in operating expenses.

Petro-Canada sees its strong commercial performance as consistent with a commitment to Canadians. We are here to serve Canada's energy interests, and are dedicated to the development of Canadian projects in a manner that is financially sound and beneficial to Canada. In the downstream, our marketing programs involve the Corporation in the activities and initiatives of people in every region of the country. Petro-Canada continues to press forward in providing opportunities to all Canadians through the implementation of its Official Languages Program and active measures to promote employment equity. As the largest Canadian-owned energy company, Petro-Canada is a leader in sports and safety programs for youth, and supports education, the arts and cultural activities. The Corporation is particularly proud to ask all Canadians to share in carrying the Olympic torch across Canada for the 1988 Winter Games.

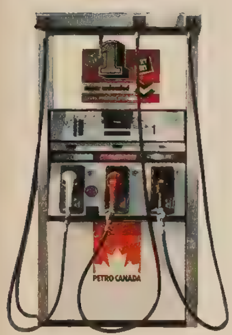
W.H. Hopper
Chairman of the Board
and Chief Executive Officer

March 23, 1987

Prices, Profits and Reinvestment

In Petro-Canada's 1985 Annual Report, Chairman of the Board W.H. Hopper discussed the factors holding down profitability in the Canadian refining and marketing industry. He expressed concern that returns on investment in the "downstream" refining and marketing sector were too low to sustain the continued investment required to maintain services to the Canadian public.

To put things into perspective, an understanding is needed of the structural changes that have challenged and transformed the downstream industry over the past 15 years. These changes continue today, and refining and marketing companies must continue to respond if they are to survive as effective businesses.



Reasonable financial returns are needed so that investments to modernize facilities can continue.

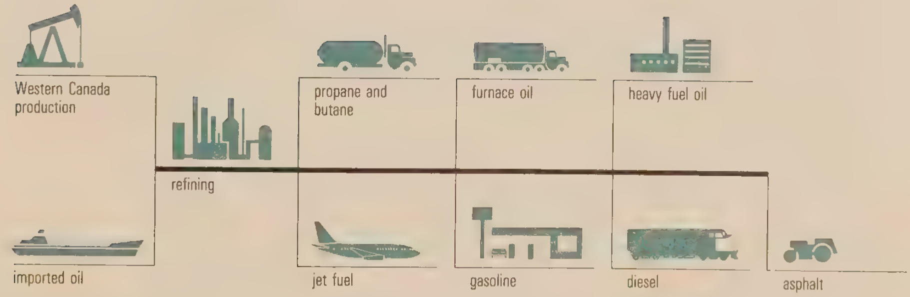
Consumer demand has changed

The price shocks in world crude oil markets of 1973-74 and 1978-79, and the more gradual price increases in between, transformed Canadians' use of energy in general and oil products in particular. Conservation efforts, such as improved home insulation and smaller cars with more fuel-efficient engines, as well as the switch to such alternative fuels as electricity and natural gas, led to an unprecedented drop in demand for petroleum products. From its peak in 1979, total domestic Canadian demand for petroleum products declined almost 25 per cent by the end of 1985. The trend to lower demand accelerated as prices peaked in the early 1980s; it had so much momentum that overall product demand continued to fall in 1986 despite the sharp drop in product prices.

Declining volume was not the only challenge facing refiners in recent years. Changes in the mix of products required by consumers pushed refineries to their limits and forced capital investments to upgrade and modify them. That trend continues, with market patterns and environmental concerns both driving technological change.

Increasingly, the market is demanding more light transportation fuels and less heavy product from each barrel of oil. In 1979, gasoline, diesel, jet fuel and petrochemical feedstocks made up 60 per cent of the overall product mix. By 1986 these light products accounted for 72 per cent of production.

Using domestic and imported crude oil, Canadian refineries produce a variety of products for industrial and consumer use.



Product pricing

The more than 60 per cent drop in world crude oil prices in early 1986 created expectations among some consumers of a similar drop in retail prices for gasoline and other products

While understandable, such expectations were not realistic. The cost of crude oil is only one of several factors which affect the final consumer price. Other costs include transportation by tanker or pipeline from wellhead to refinery, refinery processing, distribution from refinery to retail outlets, a margin for the dealer, and federal and provincial taxes levied at the pump. Most of these cost elements remain unchanged or have even increased. Looking at 1986 gasoline prices in Toronto, for example, the price for regular leaded gasoline declined 11.2 cents over the course of the year, reflecting the 12.2 cents per litre decline in crude. Both total taxes levied at the pump and the dealer margin remained relatively unchanged. The net effect was a small improvement in the amount remaining to cover the costs of refining, distributing and marketing finished products and to provide only a modest return on investment.

In response to competitive pressure, retail prices fell substantially in 1986. It should be appreciated, though, that the downstream sector has struggled through a difficult period of contraction and adjustment with very poor returns on capital employed. Some turnaround is needed to enable the industry to make the investments required in the years to come. Continued gains in efficiency and improved marketing returns will be needed to effect that turnaround.

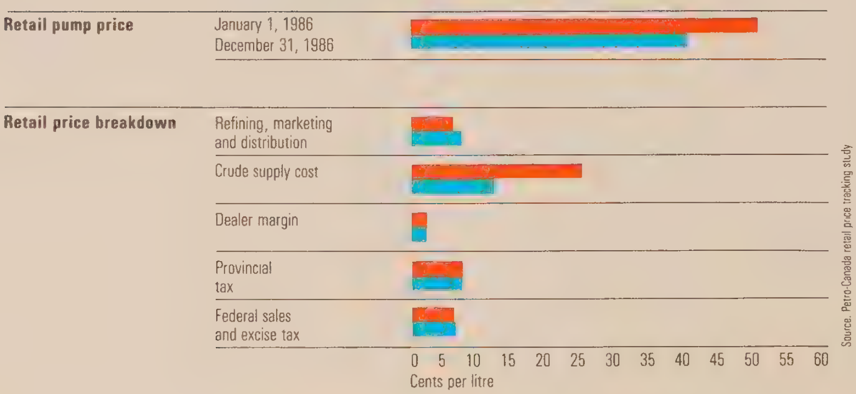
High, ongoing investments required

The decline in product demand has forced the downstream business to contract. The refining sector was particularly hard hit as refinery utilization rates plummeted. Because they have high, fixed capital and operating costs, refineries must maintain high utilization rates to operate economically. Surplus refining capacity across Canada caused 11 refineries, representing 17 per cent of industry capacity, to close between 1979 and 1986. Even so, average utilization has dropped from 87 per cent to 80 per cent. More refineries could be closed if this situation persists.

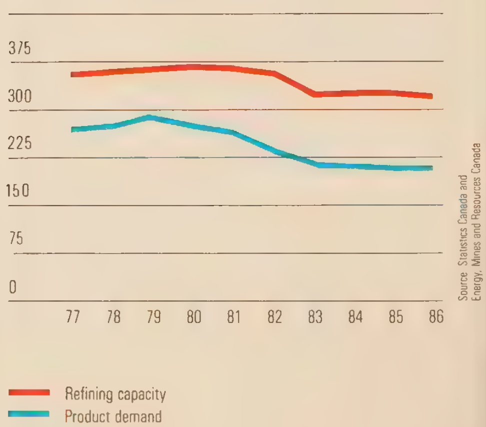
Meanwhile, refiners had to invest heavily in new processing equipment to keep up with market trends and new environmental safeguards. Older refineries, built for the product mix and crude supply of days past, had difficulty keeping up, and these were often the first to close. On the other hand, a few refiners expanded their facilities or built new plants with the latest technology, giving them some advantage in meeting product demand but adding to the general problem of overcapacity.

The fight to retain sales volume in a shrinking market has led to sustained price competition over the past few years in both wholesale and retail marketing, to the benefit of the consumer but at a cost to the financial health of the industry.

A price comparison for regular gasoline sold at self-serve stations in Toronto shows the drop in pump price was roughly equivalent to the lower crude supply cost, while other cost components stayed about the same.



Declining product demand forced refinery closures but excess capacity remains.
(thousands of cubic metres per calendar day)



Frequent protracted price wars have been a symptom of the imbalance between supply and demand. To remain competitive, marketers have continued to invest in upgrading their retail networks. Nevertheless, declining sales volumes and low margins made more and more outlets uneconomic. All companies had to rationalize their networks, selling or closing unprofitable outlets and finding ways to cut costs, boost efficiency and provide more competitive prices. These efforts resulted in the closure of approximately one quarter of all retail outlets between 1979 and 1986. Meanwhile, low wholesale prices allowed independent marketers, with no refining operations to support, to take a significant share of the retail market.

In addition, the deregulation of crude oil and refined product markets has exposed the Canadian industry to international pricing. While this policy of open access helps to maintain a high level of competition, it also reinforces the need for refineries to become more efficient.

In short, recent years have been characterized by sharply lower product demand, low refinery utilization and intense marketing competition at a time when refiners and marketers have had to make substantial investments in their operations.

Profitability has been inadequate

These dramatic changes have had a tremendous impact on the industry's financial performance. Data published by the Federal Government's Petroleum Monitoring Agency show just how extreme that impact has been.

In spite of rising crude oil prices within Canada between 1980 and 1985, downstream revenues showed virtually no growth, reflecting the dramatic slump in demand. Net income and internal cash flow declined sharply, with a consequent decline in downstream capital investment.

The return on capital employed in the downstream petroleum industry has been consistently lower than returns in manufacturing, regulated energy utilities and most other industries. The average downstream rate of return from 1981 to mid-1986 was only 3.5 per cent, well below rates of return needed to raise new capital for continued reinvestment in this or any other industry. Estimates for year-end 1986 show an improving but still inadequate picture.

Despite these weak financial results, many consumers continue to believe that product prices are unnecessarily high, and that they are kept high by some form of collusion among the major companies. The reality is that intense competition for the remaining market has forced prices down, to the benefit of the consumer. Exhaustive investigations, such as the five-year Restrictive Trade Practices Commission inquiry, have found no evidence of collusion or overcharging. The meagre returns the industry has experienced clearly support the conclusion that the consumer has been well served by a competitive market for petroleum products.

However, this poor financial performance bodes poorly for the future effectiveness of the downstream industry. The downstream is highly capital intensive, with nearly $12 billion of capital currently employed in the business. Moreover, ongoing capital investments in the order of $1 billion annually are required to meet changing consumer needs. The downstream is one of Canada's largest industries, with sales of $34 billion in 1985. It is also a major employer, supporting over 120 000 jobs directly and many more thousands indirectly.

Canada's integrated oil companies must now look more to the downstream to provide cash flow to sustain exploration and development, or Canadians may soon face depletion of existing oil and gas reserves and future shortfalls of supply. Improvement in downstream profitability to levels comparable with those in other industries is essential in coping with the severe effects of lower crude prices.

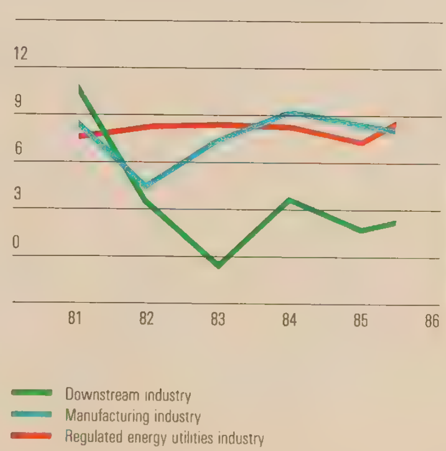
Refiners have to invest heavily in costly processing equipment to meet new environmental safeguards and keep up with changing consumer requirements.

The financial performance of Canada's downstream industry has been unsatisfactory.

(billions of dollars)	1981	1982	1983	1984	1985	1986 First Half
Revenues	33.8	35.1	33.8	31.9	34.0	14.2
Net income	1.3	0.4	(0.1)	0.4	0.2	0.3
Capital employed	11.1	11.4	12.1	12.9	13.6	11.8
Internal cash flow	2.0	1.2	0.8	1.1	1.1	0.5
Capital expenditures	2.0	2.5	1.7	1.1	0.9	0.3

Source: Petroleum Monitoring Agency

The return on capital employed for the downstream industry compares poorly with other industries. (per cent return on capital employed)



Source: Petro-Canada calculations based on published data from Petroleum Monitoring Agency and Statistics Canada

Petro-Canada in the downstream

Petro-Canada is a major participant in the Canadian refining and marketing industry, with 21 per cent of the nation's refining capacity and 23 per cent of the gasoline and distillate market.

Since entering the downstream, Petro-Canada has responded dynamically to the challenges of the business, streamlining operations, targeting marketing programs to take advantage of company strengths, and achieving greater efficiency. It seeks to remain in the forefront of innovation, adapting to changing conditions in both refining and marketing. Petro-Canada is committed to maintaining high standards in safety and environmental protection. With its Canadian perspective, it plans to take the lead in meeting the needs of the Canadian public.

Within Petro-Canada, downstream operations have a dual role. They provide petroleum products and services to the public. But they also serve as a channel through which Canadians can support the development of their country's energy resources. The slogan "Pump your money back into Canada" struck a very responsive chord among the Canadian public.

From the beginning of Petro-Canada's marketing activities, the expectation was that cash flow from product sales would help to finance the development of energy supplies for Canada's future.

With the sudden drop in cash flow from crude oil and natural gas, it is more important than ever that the downstream make that kind of contribution to ongoing energy development. Yet in recent years the return on investment in the downstream has been so meagre that it has not even covered downstream reinvestment needs.

Product prices in Canada follow competitive action in a vigorous market. Petro-Canada operates in that market on the same basis as other companies, striving for a reasonable return on investment that is adequate to sustain a vibrant business.

Financial performance must improve

Most of the trends outlined here will continue into the 1990s. Lower prices and economic recovery in much of Canada have slowed the decline in product demand, but it is expected that there will be no growth, or possibly a continued decline, over the next decade. Transportation fuels will increasingly dominate product demand, and refiners will have to invest more in upgrading their refineries. Refiners and marketers must also take further steps in environmental protection to respond to public concern and new legislation. The result will be cleaner, safer operations, but substantial capital expenditures will be required to achieve these benefits. For instance, recent environmental legislation requiring the removal of lead from gasoline, and the upgrading of underground storage tanks, will necessitate investments in the order of a billion dollars.

Vigorous competition among marketers will continue. Rival companies will have to rationalize marketing networks further to remain competitive. New services and new products will be needed to gain competitive advantage.

Improved financial performance is clearly necessary. Adequate returns are needed to meet future investment requirements. They are needed to ensure the long-term survival of a downstream industry that is able to offer the range of services and quality of products that Canadians expect. They are also essential to provide ongoing employment and business opportunities, directly and indirectly, to hundreds of thousands of Canadians.

Additional copies of this article
can be obtained from
Petro-Canada, Public Affairs
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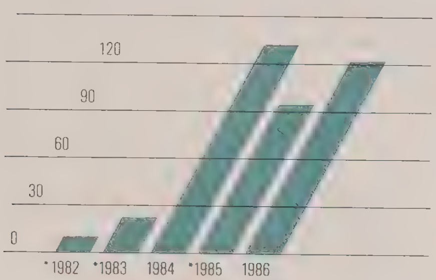
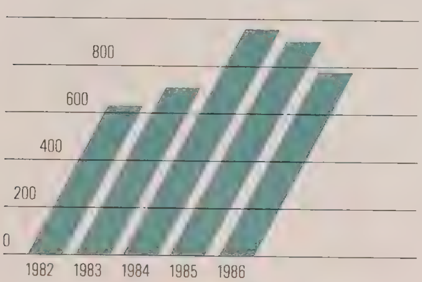
Discussion of Results

Earnings after dividends on redeemable preferred shares (millions of dollars)



*before extraordinary and unusual items

Internally generated cash from operations (millions of dollars)



Swift reaction to world oil price changes

Petro-Canada's financial and operating results for 1986 were driven by the dramatic fall in crude oil prices. In November of 1985, international crude oil prices were about U.S. $31 (Cdn. $42) per barrel; by March 1986, they had dropped to nearly U.S. $10 (Cdn. $14). During the remainder of the year, the price fluctuated between U.S. $11 and $18 (Cdn. $15 and $25). Negotiations within OPEC produced a series of tenuous agreements that limited further price drops and at times held hope for some price recovery. The overall result for Canada's oil and gas industry was that both the value of hydrocarbons produced and the value of reserves remaining in the ground fell substantially.

Petro-Canada quickly recognized that the price drop was not an aberration that would soon reverse itself, but a fundamental reaction to an imbalance between supply and demand. In January 1986, Petro-Canada began a complete review of objectives, strategies and planned activities. Rather than counting on future price increases for relief, the Corporation assumed a low and unstable crude oil price environment. Among the strategies pursued by the Corporation were making the most of existing assets, cutting costs wherever possible, downsizing the organization and keeping it flexible, and selectively investing for short-term cash flow. The Corporation's results for the year indicate that the crisis was successfully managed.

Operating results held firm

Petro-Canada's upstream production results were not markedly different from those of 1985. Production of conventional crude rose slightly as earlier investments came on stream and production efficiencies were improved. The Syncrude plant operated reliably throughout the year and production of synthetic crude reached a record level. Natural gas production was below 1985 levels due to lower demand in the United States for Canadian gas. Production of field natural gas liquids increased substantially as production from new facilities more than offset the impact of lower gas sales.

In the downstream, increased volumes of crude oil processed at the Corporation's refineries as well as higher petroleum product sales resulted from the Gulf acquisition and Petro-Canada's strong presence in every product and market segment.

Financial results encouraging in an exceptionally difficult year

Consolidated earnings (before unusual items and after redeemable preferred share dividends) were $123 million in 1986, up 28 per cent from $96 million in 1985. Reflecting the drop in crude oil prices, Resources Division earnings declined from $197 million in 1985 to $57 million in 1986. Products Division earnings climbed from a loss of $22 million to earnings of $115 million.

The Corporation's results were significantly better than those anticipated earlier in the year. This improved performance was largely a result of management's actions in reducing costs, as well as increases in downstream margins in the second half of the year. Financial results were also greatly assisted by the Gulf acquisition and the carefully implemented integration of the two organizations.

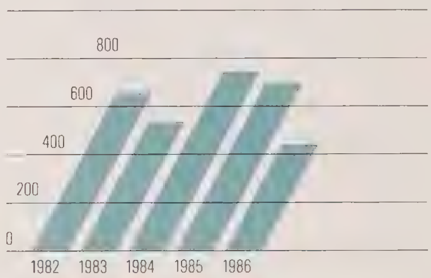
Effective January 1, 1986, the Corporation modified prospectively its full cost method of accounting in accordance with the Canadian Institute of Chartered Accountants' (CICA) Accounting Guideline "Full Cost Accounting in the Oil and Gas Industry". The purpose of the Guideline is to narrow the range of acceptable alternatives which are currently practiced in the application of the full cost method of accounting. A key issue is the maximum amount of costs which may be capitalized (the "ceiling test"). In conducting the ceiling test at December 31, 1986, the Corporation followed the CICA's prescribed method which applies year-end prices and costs to oil and gas reserves and makes provision for financing costs, administrative overhead and income taxes. The Corporation met the ceiling test by a substantial margin.

Internally generated cash from operations (after redeemable preferred share dividends) of $711 million in 1986 was down 14 per cent from $828 million a year earlier. Cash generated by the Resources Division decreased from $847 million in 1985 to $399 million. Cash contributions from the Products Division increased from $71 million in 1985 to $346 million in 1986.

Capital employed by the Corporation at year-end 1986 amounted to $7 105 million, compared to $6 783 million a year earlier. Cash flow return on capital employed declined from 12.2 per cent in 1985 to 11.1 per cent in 1986.

Early in the year, Petro-Canada moved decisively to downsize and streamline the Corporation. Cost-cutting measures and further efficiency gains were

Capital expenditures on property, plant and equipment net of petroleum incentive program grants*
(millions of dollars)



*excludes acquisitions

sought in every department. The total staff complement was reduced by 23 per cent after adjustment for the addition of Edmonton refinery personnel in April. Divisional reorganizations were undertaken to ensure that available staff were effectively assigned to priority functions. Some centralization was deemed necessary and several groups of employees were relocated.

Investment activities tailored to new business environment

Capital commitments were cut back in 1986, with emphasis placed on selectively investing for short-term cash flow while at the same time maintaining interests in the more promising longer-term development projects. In particular, investments in the Corporation's exploration program were reduced and the focus was shifted from the frontiers to conventional oil and gas properties in Western Canada. Capital expenditures in the refining and marketing business were also limited to the extent possible during integration of the former Gulf operations.

Capital expenditures on property, plant and equipment after deducting incentives decreased 37 per cent from $710 million in 1985 to $448 million in 1986. Approximately $72 million of the Corporation's capital spending was allocated to exploration for conventional oil and gas in Western Canada, $57 million to frontier exploration, $179 million for production operations, and $111 million for refining and marketing. An additional $301 million was invested in purchasing the assets and related working capital of the former Gulf Canada Limited refinery in Edmonton. The purchase, which was provided for under the terms of the 1985 acquisition agreement, took effect on April 1, 1986. It provides Petro-Canada with one of the largest, most modern and efficient refineries in the country. In addition, it increases the Corporation's refining capacity in Western Canada, where market share for petroleum products rose substantially as a result of the 1985 Gulf acquisition.

Financial structure improved

In May, the Corporation completed the issue of U.S. $200 million ten-year 7¼% debentures on the Eurobond market. In December, the Corporation issued U.S. $200 million of thirty-year 8¼% debentures in the United States. The proceeds from these debentures, totalling Cdn. $556 million, were used in part to reduce short-term indebtedness and refund other floating rate indebtedness.

Dividends of $59 million paid on redeemable preferred shares in 1986 were lower than in 1985 due to lower interest rates and share redemptions. A decline in operating working capital of $406 million was brought about by falling crude oil prices, which lowered the investment in crude oil and petroleum product inventories and in accounts receivable.

The Corporation's interest coverage ratio for 1986 was 6.3. In addition, internally generated cash from operations of $770 million was more than sufficient to fulfil Petro-Canada's fixed financial obligations, including both debt and the scheduled redemption of term preferred shares. Overall, financial ratios compared well with those at the end of 1985, demonstrating the Corporation's quick response to changing conditions so as to maintain the integrity of its financial structure.

While Petro-Canada's financial position remains fundamentally sound, it would be imprudent to rely exclusively on debt for any substantial new capital requirements arising from major expansion of the Corporation's activities. Considerable additional external financing will be required if the Corporation proceeds with major new development projects.

Resources Division Highlights

Financial and operating profile

Financial	1986	1985
Revenue (millions of dollars)	**1 080**	1 636
Earnings (millions of dollars)	**57**	197
Average capital employed (millions of dollars)	**4 104**	4 642
Cash flow return on average capital employed (per cent)	**10.0**	18.1
Capital expenditures (millions of dollars)	**319**	520

Operating	1986	1985
Crude oil and field natural gas liquids production, net before royalties (thousands of m³ per day)		
Conventional crude oil	**10.7**	10.4
Synthetic crude oil	**3.5**	3.5
Field natural gas liquids	**2.1**	1.8
Natural gas production, net before royalties (millions of m³ per day)	**10.2**	11.6
Natural gas liquids production from straddle plants (thousands of m³ per day)	**2.6**	2.6
Proven reserves of crude oil and natural gas liquids, net before royalties (millions of m³)	**88.6**	92.3
Proven reserves of natural gas, net before royalties (billions of m³)	**96.7**	98.8

The Resources Division results reflect the effectiveness of Petro-Canada's response to the collapse of world oil prices and weak natural gas export markets. Production margins were maximized by reducing operating costs while increasing production rates of crude oil and natural gas liquids. Restructuring eliminated one or more levels of supervision and merged some departments, resulting in a smaller, more focused organization that is appropriate to meet the new business environment. In addition, capital investments were reduced and increasingly directed towards field improvements that would immediately generate cash flow.

Production of crude oil and field natural gas liquids was 16 300 cubic metres per day in 1986, up 4 per cent from 1985. Because of lower demand, daily production of natural gas dropped 12 per cent to 10.2 million cubic metres. During the year, 250 000 cubic metres of crude oil and natural gas liquids and 591 million cubic metres of natural gas were added to the Corporation's reserves base, before production.

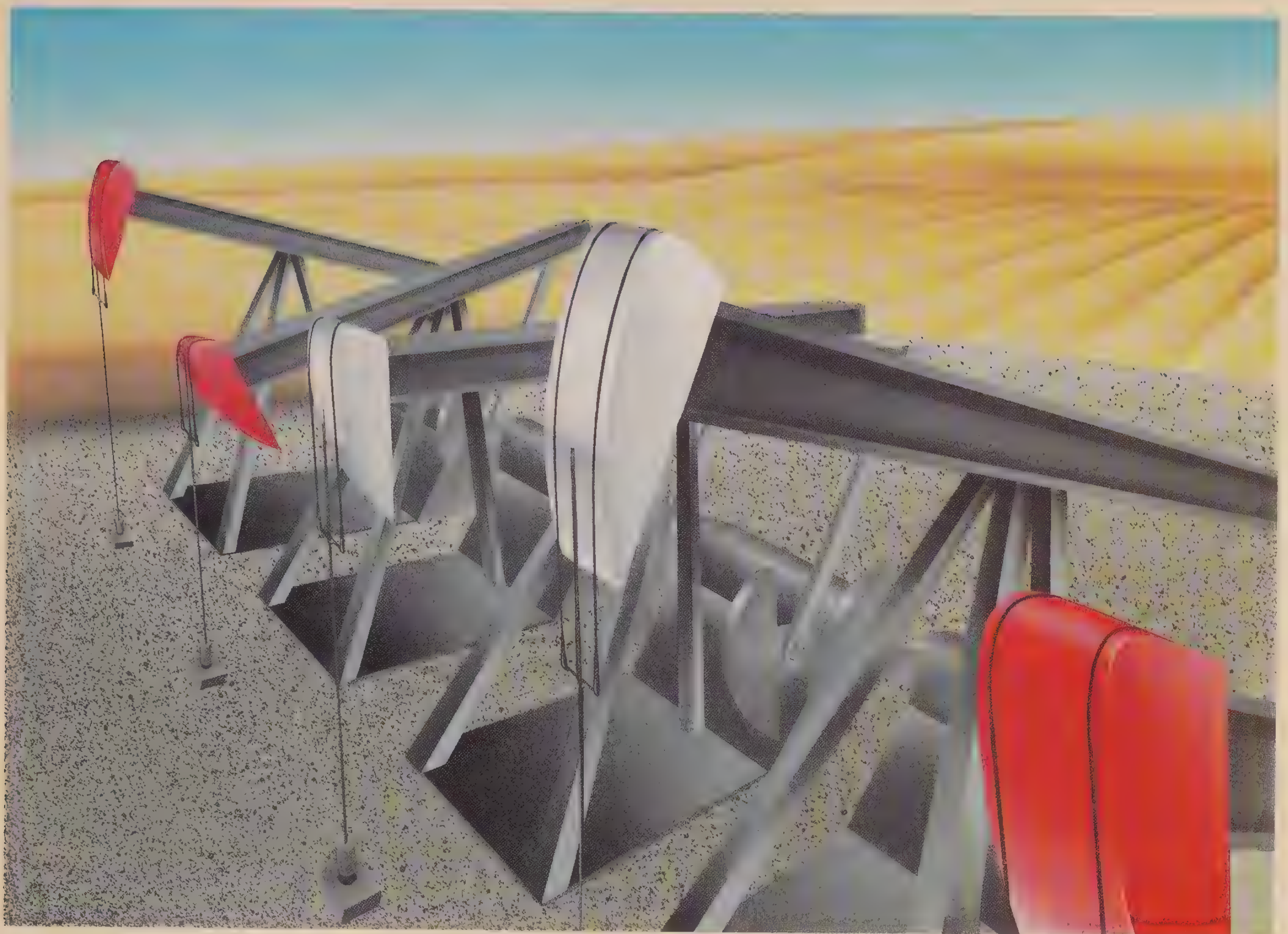
Despite sharply reduced revenues from production, the Resources Division was able to provide earnings of $57 million in 1986. Cash contributions reached $399 million. Cash flow return on average capital employed was 10.0 per cent in 1986.

Production returns optimized

Operating costs for company-operated conventional fields were reduced from 1985 levels. This was achieved as a result of an intensive review of all Petro-Canada operated producing properties as well as careful attention to detail at the field level.

While heavy emphasis was placed on cost reduction, an equal effort was made to maintain production. Well workovers were conducted more selectively and plant turnaround work was planned with greater emphasis on minimizing costs and downtime. Product recovery increased at a number of natural gas processing plants following a careful study of process operating conditions and potential efficiencies.

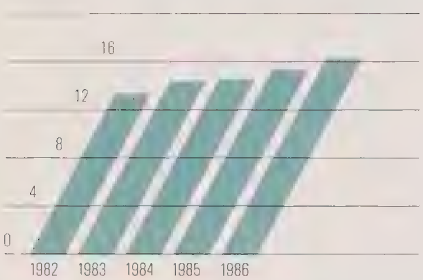
Productivity improvements at the Utikuma Lake oilfield illustrate the gains made through the focus on efficiency in 1986. Though the field is relatively mature, a variety of technical, operational, marketing and management innovations



Pumpjacks bring oil to the surface at locations throughout Western Canada. Petro-Canada is one of the country's largest producers of crude oil and natural gas liquids.

John Wasson, Brazeau area superintendent, m[illegible]
operations

Crude oil and field natural gas liquids production, net before royalties (thousands of cubic metres per day)



resulted in a 30 per cent increase in crude oil production volumes while operating costs were reduced 26 per cent from 1985 levels.

During 1986, the Resources Division took advantage of opportunities to make supplemental oil sales and thereby enhance production revenues. The supplemental oil sales program allows producers to sell, outside of regular sales contracts, portions of their production shut in by prorationing. For Petro-Canada, these sales amounted to 5 per cent of total oil production for the year.

Natural gas marketing emphasized

During the one-year transition period that preceded deregulation of Canada's natural gas industry on November 1, 1986, Petro-Canada intensified its natural gas marketing activities. The Resources Division's gas marketing capability was significantly strengthened in order to compete aggressively in the newly deregulated domestic and export sales markets.

Direct gas sales were sought in British Columbia, where the Corporation holds extensive reserves. On the first day of fully deregulated marketing, contracts were signed with pulp mills in Prince George and Prince Rupert for a total of 480 000 cubic metres a day.

Deregulation has opened a potentially large internal sales market for natural gas, particularly within Alberta. The ability to supply the Corporation's gas to Petro-Canada's own refineries, processing plants and other facilities makes it possible to operate natural gas facilities at higher load factors and to accelerate the connection of proven gas reserves. One natural gas field which the Corporation began to develop in 1986 as a result of this linkage was the Chard field near Fort McMurray, Alberta. Even in a year of depressed market conditions, arrangements

for internal sales allowed investments to begin for construction of a sweet gas plant and a gathering system to tie in 14 production wells.

Oil sands projects managed effectively

At the Syncrude oil sands mining project near Fort McMurray, Alberta, production during 1986 reached a record level. Petro-Canada's 17 per cent ownership share amounted to 3 500 cubic metres per day of synthetic crude. While near-capacity production helped to minimize the impact of high fixed costs, an expenditure reduction program further cut variable operating costs. Major cost reductions were achieved through delayed overburden removal, extended maintenance schedules and lower levels of corporate and technical support. Capital expenditures were re-examined and the expected completion of the capacity addition project, anticipated to cost a total of $740 million, was delayed by one year to the end of 1988.

During 1986, Syncrude owners and the Alberta Government agreed to conduct engineering work on the feasibility of increasing plant capacity to about 32 000 cubic metres a day.

Petro-Canada maintained its 50 per cent involvement in the partner-operated in situ oil sands project at Wolf Lake, in northeastern Alberta. The Corporation's share of production averaged over 550 cubic metres per day of bitumen by year end. In mid-1986, Petro-Canada and its partner initiated work on expanding the project's capacity to 1 300 cubic metres a day. This $23 million expenditure will serve to optimize the performance of the existing Wolf Lake project.

Discussions are underway with the Corporation's partner and governments regarding possible further expansion of the Wolf Lake project to a total capacity of 3 300 cubic metres per day.

Exploration refocused on Western Canada

With the sharp decline in crude oil prices, Petro-Canada's exploration activity emphasized lower-cost supply sources in the Western Sedimentary Basin.

During the year, significant oil and gas reserves were added to the Corporation's proven reserves base. Most notable were the Sousa and Shekilie discoveries in northwestern Alberta. These and other oil and gas discoveries resulted in accelerated follow-up drilling.

The Corporation's 11-year exploration program off Canada's East Coast entered a transition phase during 1986. Several delineation wells, such as the en-

Bill Fleming, operations superintendent, and Dwayne Zeller, process supervisor, maintain excel- ant performance and ibility at the Empress facility. The natural gas liquids straddle plant, 92 per owned by Petro ada, is the country's largest.

couraging Terra Nova I-97 and Cohasset A-52, provided a more complete assessment of earlier discoveries. Petro-Canada is continuing its evaluation of discovered fields and its active role in the delineation of the best development opportunities.

Petro-Canada also conducted a modest international program. Exploration in Colombia, Ecuador, Indonesia and Papua New Guinea is aimed at finding significant reserves of low-cost light crude oil to add to the Corporation's asset base.

Selective involvement maintained in the most attractive major projects

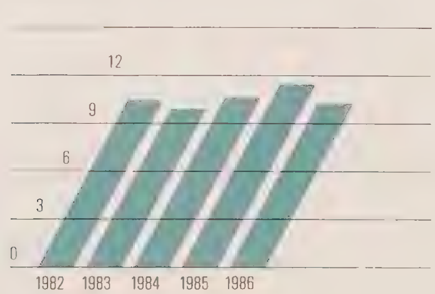
At year-end 1986, there were no plans to proceed immediately with any major development projects. However, Petro-Canada maintained its interest in the more promising of Canada's frontier and oil sands development opportunities.

During the year, the Corporation continued to work with partners and the federal and provincial governments to ensure that opportunities are advanced with appropriate timing and adequate assurance of economic success.

In April, the Canada/Newfoundland Offshore Resources Board approved, with a number of terms and conditions, the Hibernia Development Plan. Negotiations were underway at year end between the Hibernia partners and the federal and provincial governments on fiscal arrangements, taking into account the exceptionally large front-end capital investment, the long lead-time before first revenues, and low crude oil price projections.

Overall, Petro-Canada has a stronger oil and gas position off Canada's East Coast than any other company, providing an excellent base on which to build long-term profitability.

Natural gas production, net before royalties (millions of cubic metres per day)



Natural gas is prepared for pipeline shipment at processing plants in Western Canada. Deregulation will open up new markets for Petro-Canada's natural gas.

Products Division Highlights

During 1986, Petro-Canada took advantage of the many opportunities afforded by the September 1985 acquisition of refining and marketing assets from Gulf Canada Limited. Above all, the Corporation took careful stock of its consolidated assets and competitive position, and proceeded to formulate a new set of objectives and strategies for its Products Division.

Integration of supply, refining, research and development, wholesale marketing and retailing, as well as business systems, was largely completed by the end of 1986. An across-the-board restructuring was accompanied in some instances by the relocation of functions, such as the transfer of some 250 executive and professional positions from Toronto to Calgary. From this work, Petro-Canada's Products Division has emerged as an efficient new entity and a significant force in the nation's petroleum refining and marketing industry.

Products Division operating results reflected the Corporation's strong presence in every aspect of the business. Crude oil processed by Petro-Canada's refineries averaged 47 200 cubic metres per day in 1986, with refinery utilization of 72 per cent. Sales of refined petroleum products over the year were 44 300 cubic metres per day. The number of marketing outlets was reduced by 6 per cent to 4 344.

Consistent with the Corporation's expectations, Petro-Canada's sales volumes declined slightly after the Gulf acquisition. Marketing programs continued to be focused on products and markets where the company can take advantage of its product quality, operating capability and market representation to improve its return on investment.

Downstream earnings of $115 million in 1986 represented a significant gain over 1985. Primarily a reflection of improved margins during the second half of the year, these earnings led to a return on average capital employed of 4.0 per cent for the Products Division. Despite this improvement, returns in the refining and marketing business remain below acceptable levels.

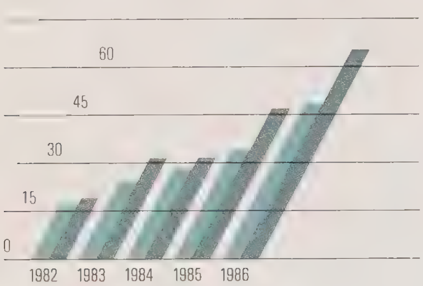
Financial and operating profile

Financial	**1986**	1985
Revenue (millions of dollars)	**4 588**	4 350
Earnings (millions of dollars)	**115**	(22)
Average capital employed (millions of dollars)	**2 846**	2 580
Return on average capital employed (per cent)	**4.0**	(0.9)
Capital expenditures (millions of dollars)	**118**	168
Acquisitions including minority interests (millions of dollars)	**301**	1010

Operating	**1986**	1985
Crude oil processed by Petro-Canada (thousands of m³ per day)	**47.2**	34.2
Refinery capacity (thousands of m³ per day)	**65.5**	46.2
Petroleum product sales (thousands of m³ per day)	**44.3**	35.5
Number of retail and wholesale outlets	**4 344**	4 620

[illegible] and then shipped by truck to wholesale and retail outlets. Petro-Canada is the nation's number two marketer of petroleum products.

Refinery capacity and crude oil processed (thousands of cubic metres per day)



[illegible]
Ford Ralph was the ongo ing program to reidentify retail gasoline outlets.

Modern, efficient Edmonton refinery purchased

A significant event for Petro-Canada was the purchase, on April 1, 1986, of the former Gulf Canada Limited refinery at Edmonton. Totally rebuilt in 1971, the refinery was expanded in 1982 to include a dedicated processing capability for synthetic crude oil – the first of its kind in Canada. The facility can handle up to 19 300 cubic metres a day of crude oil, including approximately 6 600 cubic metres a day of synthetic crude transported by pipeline from the Syncrude oil sands plant. The Edmonton refinery produces mostly gasolines, aviation fuels, solvents, diesels and by-products such as propane, butane and coke. These products are transported by road, pipeline and rail to destinations across Western Canada.

The Edmonton refinery is recognized as one of the most modern and efficient in the country. Key reasons for this are its excellent feedstock and product yield flexibility, and its capacity to produce a high ratio of light oil products. The refinery is also close to a variety of crude oil supply sources which limits the need for tankage and on-site inventories. The Corporation is achieving further efficiencies at the refinery through installation of state-of-the-art computerized controls.

Marketing facilities and business practices streamlined

Competition in the marketplace and customer expectations for low prices force a continual search for further efficiencies in both business practices and facilities. This effort has been a driving force in managing the integration of the former Gulf and Petro-Canada networks.

At year end, a major facility and systems rationalization program was nearing completion. Several product distribution terminals were closed, yielding a reduction in fixed costs and inventory requirements.

On Vancouver Island, Petro-Canada closed its Victoria distribution terminal and rebuilt and upgraded its facility in Nanaimo. Gasoline and distillates are now transported by barge from Petro-Canada's Port Moody refinery and

Jim Murphy, Edmonton Refinery manager, oversees one of the most technologically sophisticated refining operations in Canada.

distributed by truck from the Nanaimo terminal to sales locations across Vancouver Island.

Programs are also well underway to standardize the accounting, credit and distribution practices being used by marketing outlets across the country. An example is the Corporation's light oils distribution system which provides automated inventory control and improved delivery scheduling to retail outlets.

New, high-quality products emphasized

Petro-Canada decided early in 1986 to target its product development work on markets where higher standards of performance are required. In May, the Corporation became the first to introduce a gasoline that was substantially different from that of its competitors. The proprietary product, called "The New 1", is a super unleaded gasoline formulated in response to growing consumer demand for premium-grade gasolines. "The New 1" cleans both carburetor and fuel-injection systems and achieves superior engine performance and reduced maintenance costs – product characteristics increasingly sought by motorists concerned about extending the useful life of their vehicles or ensuring that new high-performance engines function the way they were designed.

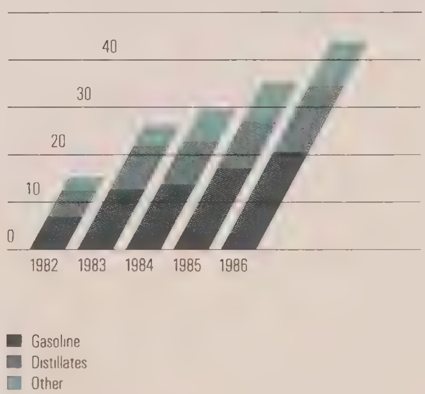
Later in the year, Petro-Canada began to extend these benefits to other gasolines, with special deposit control additives being blended in "Unleaded Plus" and "Regular Plus".

Towards year end, following extensive research at the Corporation's Sheridan Park facility, Petro-Canada introduced a new top-of-the-line lubricant called "Premium Turbo Tested" motor oil. Development of this product involved taking a very stable, specially segregated base stock from the Clarkson refinery's HydroTreating (HT) process and blending it with the latest in motor oil additives. "Premium Turbo Tested" motor oil is made to withstand the extremely hot temperatures and high loads generated by today's turbo-charged and smaller, high-revolution engines. After rigorous testing at Sheridan Park, "Premium Turbo Tested" motor oil was sent to Europe for further evaluation. In West Germany, the lubricant was subjected to the demanding Kombi Engine Test and officially approved for use in all Mercedes-Benz gasoline and diesel passenger car engines.

New products have also been launched by Petro-Canada for commercial and industrial consumers. An example was the introduction in late 1986 of

Suzanne Renaud, a marketing representative in Petro-Canada's eastern region, works to ensure that retail outlets provide the quality of service that consumers demand.

Petroleum product sales (thousands of cubic metres per day)



[illegible]eslie Lynch, a customer [illegible] manager in Petro Canada's central region works with retailers and [illegible]omers to provide the best possible service.

"Super Compressor Oil". Manufactured from HT base oil and a unique patented blend of anti-oxidant additives developed by Petro-Canada, "Super Compressor Oil" dramatically increases the length of time between servicing of compressor units.

Advanced marketing system successfully tested

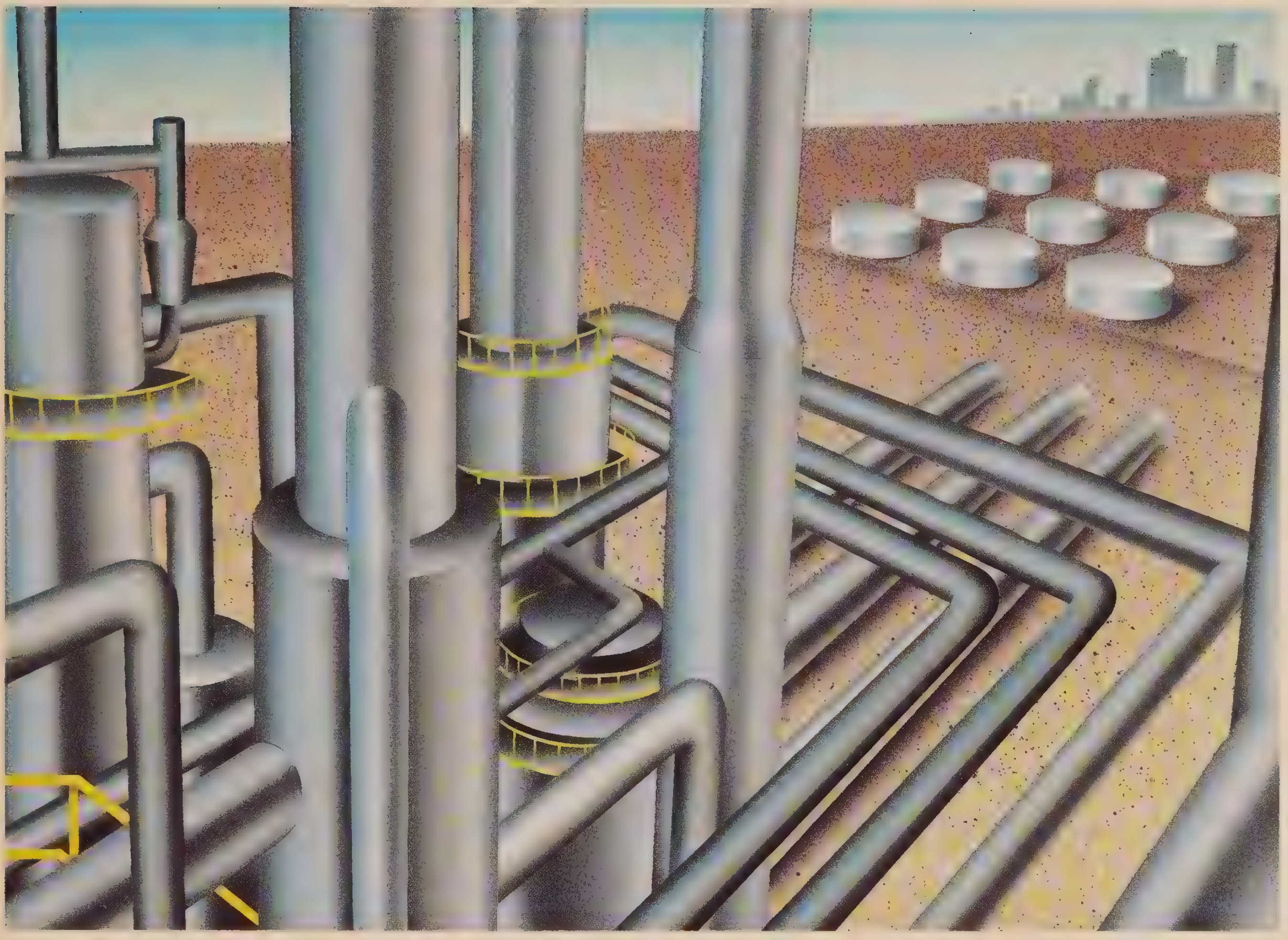
By year-end 1986, automated on-line sales data and credit authorization equipment had been installed and tested at several pilot service stations. Successful results led to the decision to begin installing this point-of-sale equipment throughout the Corporation's retail network, beginning in early 1987. Savings are expected in credit administration costs and working capital reductions.

Other advanced marketing systems, including island card terminals, are being piloted at selected retail outlets. Further developmental work will proceed on the basis of consumer reaction and evidence of potential business efficiencies. The Corporation is also actively pursuing automation initiatives in wholesale markets.

Renewed energy directed towards customer service

The Corporation's Products Division is now able to offer further improvements in customer service. Canadians have access to a complete range of Petro-Canada manufactured products through an extensive network of service stations and wholesale outlets in every region of the country. The Corporation converted to the Petro-Canada brand about one third of the former Gulf outlets during 1986, concentrating on higher-volume facilities. Much of the remaining reidentification will be completed by the end of 1987.

In addition to offering a range of new, high-quality products, Petro-Canada has set its sights on providing the best customer service in the industry. During the second half of 1986, the Corporation introduced new standards for customer service at retail and wholesale outlets in each region. These standards are being communicated throughout the network by means of a multi-faceted customer relations and training program. Successful, consistent attainment of these standards is encouraged by incentives such as the Club Excellence and Petro-Pride programs.



Corporate Responsibility

As Canada's national oil company, Petro-Canada pays extra attention to operating in ways that benefit Canadians. For many years this has meant, where possible, buying from Canadian suppliers to promote the growth of domestic businesses and employment. In areas where Petro-Canada has production and processing facilities, the Corporation has consistently supported community events. More recently, the Corporation's larger marketing network has provided new opportunities for Petro-Canada to touch the lives of Canadians.

For example, dealers and agents are encouraged to become involved in the communities in which they do business, with such programs as women's car care clinics, children's bicycle safety and youth sports. Retail gasoline promotions are directly linked to support for worthwhile Canadian initiatives, such as restoration of the Bluenose II, backing for promising Canadian Olympic athletes, and building hostels for visiting parents at children's hospitals.

Petro-Canada's donations program is balanced among all regions of the country, focusing on arts and cultural events, education, and such community-based organizations as United Way/Centraide.

The Corporation pays special attention to environmental protection. In both upstream and downstream operations, environmental audits bring potential problems to the attention of management, thereby ensuring that activities are carried out in a responsible manner. To support the federal government's promotion of a more lead-free environment, Petro-Canada has reduced lead levels in its gasoline, and has actively participated in the campaign against misfueling initiated by the Petroleum Association for Conservation of the Environment and the Federal Department of the Environment.

Petro-Canada's most exciting current initiative in the area of community involvement is its sponsorship of the 1988 Olympic Torch Relay. The Corporation undertook this enormous, 88-day project because it was an opportunity to invite all Canadians to share in the Olympic experience. The flame will be carried from St. John's, Newfoundland, along an 18 000 kilometre route through all provincial capitals, major population centres and regions of the country. Every Canadian will be given a chance to participate. As the Games open on February 13, 1988, Petro-Canada will have helped Canadians show the world the diversity and spirit of their country. A legacy of involvement with the Olympics will be left with thousands of Canadians, in hundreds of communities across Canada.

[illegible] during [illegible]

Petro-Canada

Management's Responsibility for the Financial Statements

The financial statements have been prepared by management in accordance with generally accepted accounting principles appropriate in the circumstances. Management is responsible for the other information in the Annual Report, which is consistent, where applicable, with that contained in the financial statements. Management is also responsible for installing and maintaining a system of internal control to provide reasonable assurance that reliable financial information is produced. The Corporation has an internal audit department whose functions include reviewing the system of internal control to ensure that it is adequate and functioning properly.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, a majority of which is composed of directors who are not employees of the Corporation. The committee meets with management, the internal auditors and the external auditors to satisfy itself that responsibilities are properly discharged and to review the financial statements.

The external auditors conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their examination includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board.

Auditors' Report

To the Honourable Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

We have examined the consolidated balance sheet of Petro-Canada (incorporated by Special Act of the Parliament of Canada) as at December 31, 1986 and the related consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change (with which we concur) in full cost accounting as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

We further report that, in our opinion, the transactions of the Corporation and its consolidated wholly owned subsidiaries that have come to our notice in the course of our examination of the consolidated financial statements of Petro-Canada were, in all significant respects, in accordance with the Financial Administration Act and the regulations thereto, the charter and by-laws of the Corporation and its consolidated wholly owned subsidiaries and any directives given to the Corporation.

Arthur Andersen & Co

Chartered Accountants

Calgary, Alberta
February 17, 1987

Consolidated Balance Sheet

As at December 31, 1986

(stated in millions of dollars)

Assets	**1986**	1985
Current Assets		
Accounts receivable	**$ 874**	$ 1 307
Inventories (Note 4)	**553**	1 110
Income taxes recoverable	**20**	10
Deposits and prepaid expenses	**35**	33
	1 482	2 460
Investments (Note 5)	**356**	291
Property, Plant and Equipment, net (Note 6)	**6 223**	6 030
Deferred Charges (Note 7)	**78**	65
	$ 8 139	$ 8 846

Approved on behalf of the Board

Director

Director

Liabilities and Shareholder's Equity	1986	1985
Current Liabilities		
Outstanding cheques less cash	$ 88	$ 22
Accounts payable and accrued liabilities	933	1 489
Current portion of long-term debt	13	20
Short-term notes payable	—	532
	1 034	2 063
Long-term Liabilities	69	198
Long-term Debt (Note 8)	805	269
Advances on Future Natural Gas Deliveries	129	146
Deferred Income Taxes	1 469	1 304
Redeemable Preferred Shares (Note 9)	922	1 224
Capital (Note 10)	4 161	4 161
Deficit	(450)	(519)
	3 711	3 642
	$ 8 139	$ 8 846

Consolidated Statement of Earnings

For the Year Ended December 31, 1986

(stated in millions of dollars)

	1986	1985
Revenue		
Operating	$ 5 089	$ 5 300
Investment and other income	83	81
	5 172	5 381
Expenses		
Crude oil and product purchases	2 405	2 901
Marketing, general and administrative	787	552
Producing and refining	576	553
Taxes other than income taxes (Note 11)	512	428
Depreciation, depletion and amortization	394	410
Interest on long-term debt	36	24
Other interest	31	—
	4 741	4 868
Earnings before Undernoted Items	431	513
Provision for Income Taxes (Note 12)		
Deferred	165	296
Current	84	45
	249	341
	182	172
Minority Interest	—	2
Earnings before Unusual Items and Dividends on Redeemable Preferred Shares	182	174
Unusual Items (Note 13)	—	(865)
Net Earnings (Loss) before Dividends on Redeemable Preferred Shares	182	(691)
Dividends on Redeemable Preferred Shares (Note 9)	59	78
Net Earnings (Loss) after Dividends on Redeemable Preferred Shares	$ 123	$ (769)

Consolidated Statement of Retained Earnings

For the Year Ended December 31, 1986

(stated in millions of dollars)

	1986	1985
Retained Earnings (Deficit) at Beginning of Year	**$ (519)**	$ 255
Net earnings (loss) before dividends on redeemable preferred shares	**182**	(691)
Dividends – Redeemable preferred shares	**(59)**	(78)
– Common shares	**—**	(50)
Exchange adjustment on redemption of redeemable preferred shares	**(54)**	(17)
Transfer from contributed surplus	**—**	62
Retained Earnings (Deficit) at End of Year	**$ (450)**	$ (519)

Consolidated Statement of Changes in Financial Position

For the Year Ended December 31, 1986

(stated in millions of dollars)

	1986	1985
Internally Generated Cash		
Working capital provided from operations (Note 14)	**$ 728**	$ 870
Proceeds from sale of property, plant and equipment	**59**	64
Advances on future natural gas deliveries	**(17)**	(28)
Internally generated cash from operations	**770**	906
Decrease in operating working capital (Note 15)	**406**	16
	1 176	922
Investment Activities		
Acquisition of Gulf Canada Limited assets (Note 3)	**301**	714
Expenditures on property, plant and equipment	**614**	1 059
Petroleum Incentive Program grants	**(166)**	(349)
Increase in deferred charges	**24**	4
Increase (decrease) in investments, net	**57**	(330)
Decrease in minority interest in subsidiaries	**—**	296
	830	1 394
Financing Activities and Dividends		
Proceeds from issue of long-term debt	**556**	165
Increase (decrease) in short-term notes payable, net	**(532)**	532
Redemption of redeemable preferred shares	**(356)**	(105)
Dividends – Redeemable preferred shares	**(59)**	(78)
– Common shares	**—**	(50)
Reduction of long-term debt	**(21)**	(47)
	(412)	417
Decrease in Cash	**(66)**	(55)
Cash (Deficiency) at Beginning of Year	**(22)**	33
Cash (Deficiency) at End of Year	**$ (88)**	$ (22)

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 1: Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada, an agent of Her Majesty in right of Canada, and of all subsidiary companies ("the Corporation") except Canertech Inc., which is excluded for the reason described in Note 5.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition is attributed to the related assets acquired and is amortized over the life of these assets.

(b) Inventories

Inventories are stated at the lower of cost and net realizable value.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity method. Other long-term investments are accounted for on the cost method.

(d) Property, Plant and Equipment

The Corporation accounts for its investment in oil and gas properties on the full cost method whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, drilling both productive and non-productive wells and overhead related to exploration and development. Separate cost centres have been established for each country in which the Corporation has an interest in oil and gas properties. The Corporation applies a "ceiling test", to each of its producing oil and gas cost centres, to ensure that such costs do not exceed the estimated future net revenues from production of proven reserves, at prices and operating costs in effect at the balance sheet date, together with the unimpaired costs of certain projects in Canadian frontier areas and of unevaluated properties. In addition a consolidated ceiling test provides for future administrative overhead, financing costs and income taxes.

Costs are accumulated separately for the Syncrude Project, producing in situ and other oil sands leases. Overburden removal costs relating to oil sands which will be mined in future years are deferred and are charged to earnings when the related oil sands are mined.

Substantially all of the Corporation's exploration and production activities are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

The interest cost of debt attributable to the construction of major new facilities is capitalized during the construction period.

(e) Depreciation, Depletion and Amortization

Costs incurred in producing oil and gas cost centres, other than unimpaired costs of certain projects in Canadian frontier areas and of unevaluated properties, and costs incurred on the Syncrude Project and producing in situ oil sands leases are depreciated or depleted separately on the unit of production method based on estimated proven recoverable oil and gas reserves before royalties. For purposes of calculating depreciation and depletion, natural gas production and reserves are converted to equivalent units of crude oil based on the relative energy content of each commodity.

Costs incurred in non-producing oil and gas cost centres and other oil sands leases are subject to review for impairment. Any impairment is charged to earnings. When exploration proves to be successful, and economic viability has been established, the unimpaired balance is depleted on the unit of production method when production commences.

Depreciation of other plant and equipment is provided on either the unit of production method or the straight line method as appropriate. Straight line depreciation rates are based on the estimated service life of the related asset.

(f) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming depreciation, exploration, development and other costs for income tax purposes which differ from the related amounts charged to expense.

(g) Translation of Foreign Currency

Current assets, except inventories and prepaid expenses, current liabilities and long-term debt are translated at rates of exchange in effect at the balance sheet date. Long-term assets, inventories, prepaid expenses, deferred income taxes and redeemable preferred shares are translated at rates of exchange in effect at the respective transaction dates. Revenue and expense items are translated at the average rates of exchange in effect during the year, except for depreciation, depletion and amortization, which reflect rates of exchange in effect when the assets were acquired.

The resulting exchange gains or losses are included in earnings, except for unrealized exchange gains or losses arising on translation of long-term debt, which are deferred and amortized over the remaining term of the debt.

Foreign operations are integrated with the Corporation's other activities and are translated in the above-described manner.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 1: Summary of Significant Accounting Policies (continued)

(h) Pension Plans
Costs of pension benefits for current services of employees are funded and are charged to earnings as they accrue. Costs arising from amendments to pension plans which relate to services of employees in prior years and experience deficiencies are funded in accordance with applicable pension legislation and charged to earnings over periods not exceeding fifteen years.

Note 2: Full Cost Accounting

Effective January 1, 1986 the Corporation modified prospectively its full cost accounting for oil and gas properties in accordance with the Canadian Institute of Chartered Accountants' Accounting Guideline "Full Cost Accounting in the Oil and Gas Industry" (Note 1 (d) and (e)). The effect of this change has been to increase 1986 earnings before unusual items and dividends on redeemable preferred shares by $17 million.

Note 3: Acquisition of Gulf Canada Limited Assets

Pursuant to a 1985 agreement, the Corporation agreed to acquire certain refining and marketing assets from Gulf Canada Limited. In 1985, assets were acquired for $714 million and, effective April 1, 1986, the remaining assets, consisting mainly of the Edmonton refinery, were acquired for a further $301 million.

The net assets acquired in 1986, at attributed values, consist of:

Property, plant and equipment	$ 291
Investments	1
Net working capital	9
	$ 301

Note 4: Inventories

	1986	1985
Crude oil, refined products and merchandise	$ 498	$ 1 044
Materials and supplies	55	66
	$ 553	$ 1 110

Note 5: Investments

	1986	1985
At equity		
Westcoast Transmission Company Limited	$ 177	$ 181
Petro-Canada Centre	84	24
Sedpex Inc.	31	23
Other	17	12
At cost		
Mortgages and other investments	47	51
	$ 356	$ 291

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 5: Investments (continued)

Westcoast Transmission Company Limited ("Westcoast")
At December 31, 1986, the Corporation held 30.8% of the outstanding common shares of Westcoast.

Westcoast is a regulated utility and is subject to regulatory directives which may change the components of the cost of service. Changes resulting from such directives do not have a direct effect on net earnings due to rate of return on rate base considerations which are also taken into account in the regulatory process.

At December 31, 1986, the quoted market value of the Corporation's investment in Westcoast was $165 million (1985 – $228 million).

Petro-Canada Centre
At December 31, 1986, the Corporation held 50% of a joint venture which owns Petro-Canada Centre, an office complex in Calgary. The Corporation has entered into a long-term lease for use of a portion of the complex and has guaranteed $232 million of long-term debt related to the facility.

Sedpex Inc.
At December 31, 1986, the Corporation held 50% of the outstanding common shares of Sedpex Inc., a company which owns a semi-submersible drilling vessel. This vessel is under lease to the Corporation.

Canertech Inc. ("Canertech")
The accounts of Canertech, a wholly owned subsidiary company, have been excluded from consolidation because a formal plan exists to dispose of the investment in the subsidiary. In response to a directive by the Government of Canada, the Corporation incorporated Canertech in 1981 to develop alternate energy sources. At that time the Government indicated its intention of purchasing the Corporation's investment at cost and establishing Canertech as an independent crown corporation. During 1984 the Government directed the Corporation to bring about the dissolution of Canertech. The Corporation is proceeding with the implementation of this directive. The Corporation's investment in Canertech is carried in the accounts at its original cost of one dollar.

Note 6: Property, Plant and Equipment

	1986			1985
	Cost*	Accumulated Depreciation, Depletion and Amortization	Net	Net
Natural resources				
Oil and gas				
Canada	$ 5 045	$ 1 788	$ 3 257	$ 3 307
Foreign				
– producing	64	39	25	34
– non-producing	99	80	19	22
Oil sands				
Syncrude Project	667	113	554	526
Producing in situ	99	8	91	80
Other oil sands	203	203	—	—
Natural gas liquids	204	69	135	143
Other	108	79	29	38
	6 489	2 379	4 110	4 150
Refined oil products	2 341	366	1 975	1 737
Other property, plant and equipment	253	115	138	143
	$ 9 083	$ 2 860	$ 6 223	$ 6 030

At December 31, 1986, $3 103 million of Canada oil and gas net costs were subject to depreciation and depletion.

*Cost is net of related Petroleum Incentive Program grants and investment tax credits.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 7: Deferred Charges

	1986	1985
At cost		
Oil sands overburden removal costs	$ 43	$ 44
Less portion related to oil sands to be mined within one year	11	14
	32	30
At amortized cost		
Deferred financing costs	16	4
Translation adjustment on long-term debt	11	20
Other	19	11
	$ 78	$ 65

Note 8: Long-term Debt

	Maturity	1986	1985
In Canadian dollars			
8.25% unsecured notes	1993	$ 14	$ 14
5.75% unsecured notes		—	7
Other	1987	1	1
In United States dollars			
7.25% unsecured debentures (U.S. $200 million)	1996	276	—
8.25% unsecured debentures (U.S. $200 million)	2016	276	—
LIBOR less 0.8% unsecured notes (U.S. $125 million)	1995	173	175
9% unsecured notes (U.S.$38 million)	1996	52	58
7.75% unsecured notes (U.S. $14 million)	1993	19	19
8.45% unsecured notes (U.S. $5 million)	1987	7	14
Other		—	1
		818	289
Less current portion		13	20
		$ 805	$ 269

Repayment of long-term debt

The minimum repayment of long-term debt in each of the next five years is as follows:

1987 – $13 million
1988 – $ 8 million
1989 – $ 8 million
1990 – $ 8 million
1991 – $ 8 million

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 9: Redeemable Preferred Shares

The redeemable preferred shares, which were issued by a subsidiary to a group of Canadian chartered banks, are floating rate, cumulative and non-voting. Cumulative dividends, payable quarterly, are, at the option of the subsidiary, based on a percentage of either the United States Base Rates or the London Inter-Bank Offered Rates of the banks. At December 31, 1986, the dividend rate was approximately 3.5% per annum. The shares are redeemable, at the option of the subsidiary, at one hundred dollars U.S. per share, plus accrued dividends. In 1986 the subsidiary exercised its option to redeem 850 000 shares (1985 – 750 000 shares) for a consideration of U.S. $85 million (1985 – U.S. $75 million) and repurchased 1 728 000 shares for a consideration of U.S. $172 million. At December 31, 1986, 7 872 000 shares were outstanding.

Under the terms of an agreement between the banks and the Corporation, in the event that the subsidiary does not exercise its option to redeem the shares over a seven-year period ending December 31, 1993, or in the event of certain other occurrences under the provisions of the agreement, the banks have the option to require the Corporation to purchase the shares at one hundred dollars U.S. per share, plus accrued dividends. These annual options increase from U.S. $78 million to U.S. $139 million over the remaining period.

Note 10: Capital

Authorized

(a) 71 188 common shares with a par value of one hundred thousand dollars each, and

(b) Preferred shares issued to the Government of Canada provided that the amount of such shares together with any loans received, and outstanding, from the Consolidated Revenue Fund of the Government of Canada is not in excess of one billion dollars.

Issued (to the Government of Canada)

	Number of Shares	Consideration
Common Shares		
Balance at beginning and end of year	31 883	$ 3 188
Preferred Shares		
Balance at beginning and end of year	972 771 853	973
Total Capital at End of Year		$ 4 161

The preferred shares have a par value of one dollar each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 11: Taxes Other than Income Taxes

	1986	1985
Federal sales tax	**$ 411**	$ 249
Petroleum and Gas Revenue Tax	**38**	124
Other	**63**	55
	$ 512	$ 428

Note 12: Income Taxes

The provision for income taxes of $249 million (1985 – $341 million) represents an effective rate of 57.8% (1985 – 66.5%) on earnings before income taxes of $431 million (1985 – $513 million). The computation of the provision, which requires adjustment to earnings before income taxes for non-taxable and non-allowable items, is as follows:

	1986	1985
Earnings before income taxes	**$ 431**	$ 513
Add (deduct)		
Royalties and other payments to provincial governments	**169**	307
Federal allowances		
Resource allowance	**(127)**	(260)
Tax depletion	**(39)**	(21)
Inventory allowance	**(5)**	(30)
Petroleum and Gas Revenue Tax	**38**	124
Non-deductible depreciation, depletion and amortization	**81**	95
Non-taxable gains	**(21)**	(1)
Equity in earnings of affiliates	**(18)**	(22)
Other	**(3)**	3
Earnings as adjusted before income taxes	**$ 506**	$ 708
Canadian Federal income tax at 47.8% (1985 – 46.9%) applied to earnings as adjusted	**$ 242**	$ 332
Provincial and other income taxes, net of federal abatement	**12**	16
Provincial income tax rebates	**(5)**	(7)
Provision for income taxes	**$ 249**	$ 341

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 13: Unusual Items

The unusual items charged to earnings in 1985 consisted mainly of asset write-downs associated with Canadian frontier oil and gas properties, process development costs and oil sands properties.

Note 14: Working Capital Provided from Operations

	1986	1985
Earnings before unusual items and dividends on redeemable preferred shares	**$ 182**	$ 174
Add (deduct):		
Depreciation, depletion and amortization	**394**	410
Deferred income taxes	**165**	296
Equity earnings, net of dividends received	**—**	(7)
Other	**(13)**	(3)
	$ 728	$ 870

Note 15: Changes in Components of Operating Working Capital

The increase (decrease) in operating working capital consists of:

	1986	1985
Accounts receivable	**$ (433)**	$ 470
Inventories	**(557)**	264
Income taxes recoverable	**10**	(13)
Deposits and prepaid expenses	**2**	12
Accounts payable and accrued liabilities	**556**	(681)
Operating working capital acquired from Gulf Canada Limited (Note 3)	**(9)**	(293)
Accruals relating to 1985 unusual items and other	**25**	225
	$ (406)	$ (16)

Operating working capital is comprised of working capital other than cash, short-term notes payable and current portion of long-term debt.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 16: Pension Plans

Based on the most recent actuarial valuations of the Corporation's pension plans, at December 31, 1986 all accrued and vested benefits were fully funded. The actuarial projections of employees' compensation to time of retirement indicate that there was a present value obligation of $36 million (1985 – $67 million) for pension benefits relating to plan amendments and experience deficiencies. This amount is being funded in accordance with the applicable pension legislation.

Note 17: Material Transactions with Related Parties

Transactions with the Government of Canada and its agencies are in the normal course of business and are therefore on the same terms as those accorded to non-related parties.

Note 18: Segmented Information

The Corporation operates in two business segments:

Natural resources, comprising exploration, development, production, transportation and marketing activities for crude oil, natural gas, field liquids, sulphur and oil sands; and extraction of liquids from natural gas.

Refined oil products, comprising purchase and sale of crude oil, refining crude oil into oil products and distribution and marketing of these and other purchased products.

Financial information by business segment is presented in the following table as though each segment were a separate business entity. Inter-segment transfers of products, which are accounted for at market value, are eliminated on consolidation. Corporate and other includes investment income, interest expense and unallocated general corporate revenues and expenditures. Corporate and other assets are principally cash and short-term deposits, investments in other companies and general corporate assets.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 18: (continued)

	Natural Resources		Refined Oil Products		Corporate and Other		Consolidated	
	1986	1985	**1986**	1985	**1986**	1985	**1986**	1985
Revenue								
Sales to customers and other revenues	**$ 546**	$ 976	**$ 4 588**	$ 4 350	**$ 38**	$ 55	**$ 5 172**	$ 5 381
Inter-segment sales	**534**	660	**—**	—	**—**	—		
Segment Revenue	**$ 1 080**	$ 1 636	**$ 4 588**	$ 4 350	**$ 38**	$ 55		
Earnings								
Operating earnings before depreciation, depletion and amortization	**$ 470**	$ 888	**$ 365**	$ 51	**$ 57**	$ 10	**$ 892**	$ 949
Depreciation, depletion and amortization	**(245)**	(299)	**(141)**	(107)	**(8)**	(4)	**(394)**	(410)
Interest	**—**	—	**—**	—	**(67)**	(24)	**(67)**	(24)
Provision for income taxes	**(168)**	(392)	**(109)**	34	**28**	17	**(249)**	(341)
Earnings (Loss) before Unusual Items and Dividends on Redeemable Preferred Shares	**$ 57**	$ 197	**$ 115**	$ (22)	**$ 10**	$ (1)	**$ 182**	$ 174
Capital Expenditures								
Capital expenditures on property, plant and equipment*, deferred charges and investments	**$ 319**	$ 520	**$ 118**	$ 168	**$ 92**	$ (172)	**$ 529**	$ 516
Acquisitions including minority interests	**—**	—	**301**	1 010	**—**	—	**301**	1 010
	$ 319	$ 520	**$ 419**	$ 1 178	**$ 92**	$ (172)	**$ 830**	$ 1 526
Total Assets	**$ 4 392**	$ 4 510	**$ 3 222**	$ 3 890	**$ 525**	$ 446	**$ 8 139**	$ 8 846
Capital Employed	**$ 4 102**	$ 4 107	**$ 2 698**	$ 2 995	**$ 305**	$ (319)	**$ 7 105**	$ 6 783

*After deduction of related Petroleum Incentive Program grants and investment tax credits.

Note 19: Comparative Figures

Certain reclassifications have been made to the 1985 comparative figures to conform with the current year's presentation.

Note 20: Commitments and Contingencies

(a) Commitments
The Corporation has leased property and equipment under various long-term operating leases for periods up to 2008. The minimum annual rentals for non-cancellable operating leases are estimated at $55 million in 1987, $51 million in 1988, $48 million in 1989, $42 million in 1990, $37 million in 1991 and $15 million per year thereafter until 2008.

(b) Contingencies
The Corporation is involved in litigation and claims associated with normal operations. Management is of the opinion that any resulting settlements would not materially affect the financial position of the Corporation.

Supplementary Financial Information Reporting the Effects of Changing Prices (Unaudited)

December 31, 1986

Basis of Presentation

Petro-Canada's financial statements report financial information on the basis of historical cost in accordance with generally accepted accounting principles. Although the rate of inflation declined substantially in recent years, historically the economy has experienced significant inflationary increases and many of the effects of such increases are not reflected in the traditional financial statements. The additional costs required to replace inventories and property, plant and equipment, and the effects of holding net monetary liabilities or assets are not reflected in the historical cost financial statements. The Canadian Institute of Chartered Accountants (CICA) has issued recommendations relating to the preparation of information reporting the effects of changing prices. These recommendations are considered experimental by the CICA.The intent is to determine if this information is helpful to the users of financial information in their assessment of an enterprise. The following information has been prepared based upon the CICA recommendations, except for the computation of the provision for income taxes which is addressed below.

While Petro-Canada has prepared this information using what are considered to be reasonable assumptions, it should be noted that the recommendations call for a degree of subjectivity and materially different results could be obtained if other equally valid assumptions were used. Additionally, the recommendations recognize that the cost of exploration and development required to replace oil and gas reserves is subject to a high degree of uncertainty. Despite this, the recommendations call for the estimating of the current cost of oil and gas reserves and suggest the use of indices. Petro-Canada has followed this approach but cautions that these current cost estimates may be misleading and do not necessarily represent amounts for which the reserves could be bought or costs which would be incurred in future periods if the reserves were replaced.

Explanation of Information

The schedule of Balance Sheet Items on a Current Cost Basis reports the current cost of inventory and property, plant and equipment and the effect of the current cost adjustments on net assets. The current cost of property, plant and equipment has been calculated through the use of indices. Net assets represents the historical common shareholder's equity adjusted for the current cost adjustments.

The Consolidated Statement of Earnings on a Current Cost Basis presents a comparison of the Corporation's statement of earnings as presented in the historical cost financial statements with similar data prepared on a current cost basis. Crude oil and product purchases expense has been adjusted to reflect the current cost of these purchases at the time of use. Depreciation expense has been adjusted so that it reflects the estimated current cost of replacing the operating capacity of property, plant and equipment. The CICA recommends that the amount of income tax in the computation of earnings on the current cost basis be the same as the amount charged against earnings in the historical cost financial statements. However, the Corporation believes that it is more appropriate to adjust the provision for deferred income taxes in recognition of the adjusted cost of sales and depreciation, depletion and amortization expense. Since this unaudited supplementary information is experimental, these adjustments have been reflected in the computation of deferred income taxes in the Consolidated Statement of Earnings on a Current Cost Basis. Had the Corporation followed the CICA recommendations with regard to income tax expense in the computation of current cost earnings, the provision for deferred income taxes would have been $165 million. It should be noted that there is no provision under current tax law for these current cost adjustments.

The schedule of Other Supplementary Current Cost Information presents the remaining financial information required by the recommendations. The financing adjustment represents the portion of current cost adjustments that relate to the net monetary liabilities of Petro-Canada. The CICA has defined this as "the amount of changes during a reporting period in the current cost of assets held by an enterprise that, on the basis of the existing relationship between debt and equity, do not need to be charged against present and future revenues to provide for maintenance of the common shareholders' proportionate interest in the operating capability of the enterprise". The second portion of the schedule isolates the inflation component from the total change in current cost of property, plant and equipment and inventories. The final information presented is the gain in general purchasing power that results from having net monetary liabilities. This arises because inflation erodes the purchasing power of money and therefore where there are net monetary liabilities a "gain" is recognized due to the net monetary liabilities requiring the use of less "purchasing power" over time during inflationary periods.

The CICA recommendations also require the disclosure of oil and gas reserve data, net of royalties. The schedule of Supplementary Reserve Information provides this information.

Balance Sheet Items on a Current Cost Basis
December 31, 1986

(stated in millions of dollars)

	As reported in the historical cost statements	Current cost basis
Inventory	$ 553	$ 585
Property, plant and equipment, net	$ 6 223	$ 8 553
Net assets (shareholder's equity)	$ 3 711	$ 6 073

Consolidated Statement of Earnings on a Current Cost Basis
For the Year Ended December 31, 1986

(stated in millions of dollars)

	As reported in the historical cost statements	Current cost basis
Revenue		
Operating	$ 5 089	$ 5 089
Investment and other income	83	83
	5 172	5 172
Expenses		
Crude oil and product purchases	2 405	2 158
Marketing, general and administrative	787	787
Producing and refining	576	576
Taxes other than income taxes	512	512
Depreciation, depletion and amortization	394	532
Interest on long-term debt	36	36
Other interest	31	31
	4 741	4 632
Earnings before Undernoted Items	431	540
Provision for Income Taxes		
Deferred	165	235
Current	84	84
	249	319
Earnings before Dividends on Redeemable Preferred Shares	$ 182	$ 221

Other Supplementary Cost Information

For the Year Ended December 31, 1986

(stated in millions of dollars)

1) Financing adjustment	
Based on the decrease during the year in the current cost of property, plant and equipment and inventory	$ (13)
Based on the current cost adjustments which increased earnings before income taxes for the year	$ (31)
2) (Decrease) in the current cost of property, plant and equipment and inventory	$ (45)
Effect of general inflation	378
Excess of general inflation over the current cost adjustment	$ 423
3) Gain in general purchasing power from having net monetary liabilities	$ 99

Supplementary Reserve Information

December 31, 1986

	Oil	Natural Gas Liquids	Gas
	(thousands of cubic metres)	*(thousands of cubic metres)*	*(millions of cubic metres)*
Proven reserves, net after royalties at December 31, 1985	34 713.9	5 493.5	77 862.0
Revisions of previous estimates	2 948.6	310.4	1 798.7
Extensions and discoveries	199.4	—	485.8
Production	(3 128.1)	(540.9)	(2 824.0)
Proven reserves, net after royalties at December 31, 1986	34 733.8	5 263.0	77 322.5

The above figures do not include Petro-Canada's 17% interest in the synthetic crude oil reserves of Syncrude Canada Limited ("Syncrude") (37 821.0 thousand cubic metres before royalty at December 31, 1986). Pursuant to an agreement between the Province of Alberta as lessor of the oil sands leases and the Syncrude participants, the Province has the right to 50% of Syncrude's deemed net profits, as defined in the agreement. At the Province's option, this right may be converted to a 7.5% gross production royalty. Both the 50% of deemed net profits and the 7.5% gross production royalty are subject to change under certain circumstances. In view of these options, and the attendant uncertainties relating to future prices and costs, the Corporation has not presented its synthetic crude oil reserves net of royalties.

Five Year Financial Summary

(stated in millions of dollars)

	1986	1985	1984	1983	1982
Summary of Earnings					
Revenue	**$ 5 172**	$ 5 381	$ 4 988	$ 4 171	$ 2 795
Expenses	**4 741**	4 868	4 376	3 797	2 440
	431	513	612	374	355
Add (deduct):					
Provision for income taxes	**(249)**	(341)	(385)	(268)	(230)
Minority interest	**—**	2	5	6	5
Earnings before unusual and extraordinary items and dividends on redeemable preferred shares	**182**	174	232	112	130
Unusual items	**—**	865	—	—	19
Extraordinary items	**—**	—	—	17	—
Net earnings (loss) before dividends on redeemable preferred shares	**182**	(691)	232	95	111
Dividends on redeemable preferred shares	**59**	78	100	86	120
Net earnings (loss) after dividends on redeemable preferred shares	**$ 123**	$ (769)	$ 132	$ 9	$ (9)
Other Financial Data					
Internally generated cash from operations	**$ 770**	$ 906	$ 968	$ 708	$ 625
Expenditures on property, plant and equipment	**614**	1 059	1 131	997	952
Petroleum Incentive Program grants	**166**	349	380	469	300
Acquisitions including minority interests	**301**	1 010	(2)	530	345
Total assets	**8 139**	8 846	8 966	8 194	7 542
Average capital employed	**6 944**	7 447	7 741	7 080	6 443
Working capital	**448**	397	905	809	841
Long-term debt (Note 3)	**818**	289	157	188	331
Redeemable preferred shares	**922**	1 224	1 312	1 394	1 464
Shareholder's equity	**3 711**	3 642	4 478	3 932	3 284

Notes:

1. Financial and operating results are included from May 1, 1982, for the operations of Panarctic Oils Ltd., from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, and from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the former Gulf Canada Limited Edmonton refinery.
2. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
3. Long-term debt includes current maturities.

Five Year Operating Summary

	1986	1985	1984	1983	1982
Oil and Gas Landholdings (gross/net)					
(millions of hectares)					
Non-frontier areas					
Conventional	**3.7/2.0**	4.4/2.1	4.8/2.4	6.0/3.1	6.4/3.3
Oil sands	**1.1/0.4**	1.0/0.4	0.9/0.3	0.9/0.3	0.8/0.3
	4.8/2.4	5.4/2.5	5.7/2.7	6.9/3.4	7.2/3.6
Frontiers	**14.2/8.0**	33.2/16.5	41.6/20.5	54.4/25.0	55.7/25.6
International	**1.2/0.5**	3.4/1.1	2.8/0.4	1.7/0.1	0.6/0.1
Total oil and gas landholdings	**20.2/10.9**	42.0/20.1	50.1/23.6	63.0/28.5	63.5/29.3
Wells Drilled (gross/net)					
Non-frontier areas – exploratory wells					
Oil	**21/13**	42/30	65/45	41/30	52/32
Gas	**34/15**	50/27	25/11	24/16	28/15
Dry	**42/24**	75/53	74/47	68/48	48/36
	97/52	167/110	164/103	133/94	128/83
Non-frontier areas – development wells					
Oil	**283/51**	482/169	344/134	148/84	129/68
Gas	**32/10**	47/26	16/6	17/12	138/86
Oil sands	**4/2**	0/0	193/96	27/13	0/0
Dry	**14/7**	48/21	24/10	9/5	49/31
	333/70	577/216	577/246	201/114	316/185
Frontiers and international – exploratory and development wells					
Oil	**9/2**	16/4	9/2	5/1	7/1
Gas	**9/3**	10/4	9/2	6/2	3/1
Dry	**19/6**	26/7	25/8	14/5	7/1
	37/11	52/15	43/12	25/8	17/3
Total wells drilled	**467/133**	796/341	784/361	359/216	461/271
Proven Reserves (net before royalties) (Note 3)					
Natural gas (billions of m^3)	**96.7**	98.8	120.4	134.3	135.8
Crude oil (millions of m^3)	**43.4**	45.3	48.4	45.0	47.1
Natural gas liquids (millions of m^3)	**7.1**	7.4	6.4	7.4	7.7
Synthetic crude oil (millions of m^3)	**37.8**	39.1	25.4	26.3	27.4
Foreign crude oil (millions of m^3)	**0.3**	0.5	0.8	0.9	0.9
Total crude oil and natural gas liquids (millions of m^3)	**88.6**	92.3	81.0	79.6	83.1

	1986	1985	1984	1983	1982
Daily Production (net before royalties)					
Natural gas (millions of m^3)	**10.2**	11.6	10.8	10.0	10.6
Crude oil (thousands of m^3)	**10.3**	10.0	10.3	9.3	9.3
Field natural gas liquids (thousands of m^3)	**2.1**	1.8	1.5	1.5	1.5
Natural gas liquids from straddle plants (thousands of m^3)	**2.6**	2.6	2.6	2.5	2.7
Synthetic crude oil (thousands of m^3)	**3.5**	3.5	2.3	3.0	2.3
Foreign crude oil (thousands of m^3)	**0.4**	0.4	0.4	0.5	0.2
Total crude oil and natural gas liquids (thousands of m^3)	**18.9**	18.3	17.1	16.8	16.0
Refining					
Refinery crude capacity (thousands of m^3 per day)	**65.5**	46.2	31.6	31.6	18.9
Crude oil processed by Petro-Canada (thousands of m^3 per day)	**47.2**	34.2	27.6	25.3	16.6
Refinery utilization (per cent)	**72**	78	86	78	86
Marketing					
Wholesale and retail marketing outlets	**4 344**	4 620	2 716	3 107	1 605
Petroleum product sales (thousands of m^3 per day)					
Gasoline	**20.3**	16.3	13.9	12.9	7.3
Distillates	**16.2**	12.2	9.6	8.7	5.1
Other including petrochemicals	**7.8**	7.0	6.3	5.5	2.9
Total petroleum product sales	**44.3**	35.5	29.8	27.1	15.3
Employees					
Number at year end	**7 740**	9 747	6 798	6 272	5 918

Notes:

1. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
2. Operating results are included from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the former Gulf Canada Limited Edmonton refinery.
3. Proven reserves do not include any reserves associated with frontier discoveries in Northern Canada and the East Coast offshore.

Executive Council members,
left to right:
David O'Brien, Bill Hopper,
Bob Mayo, Ed Lakusta
and Jim Stanford.

Board of Directors

†*Wilbert (Bill) H. Hopper
Chairman of the Board
and Chief Executive Officer
Petro-Canada
Calgary, Alberta

†Edward M. Lakusta
President
and Chief Operating Officer
Petro-Canada
Calgary, Alberta

*Robin Abercrombie
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A.E. Barroll Resource
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Barristers and Solicitors
Montreal, Quebec
(resigned January 1987)

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Calgary, Alberta

*Audit Committee Member
†Executive Committee Member

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Chairman of the Board
and Chief Executive Officer

Edward M. Lakusta
President
and Chief Operating Officer

David P. O'Brien
Executive Vice-President

Robert J. Mayo
President
Petro-Canada Products

James M. Stanford
President
Petro-Canada Resources

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Gottschalk + Ash
International

Illustration.
Alain Lévesque

Photography.
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Bernard Bohn

Printing
McAra Printing

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Petro-Canada
1987 Annual Report

Contents

Conversion Table

Metric conventions are used in this report except for several mentions of crude oil and natural gas prices and measurements in the feature article relating to the North American natural gas industry.

1 cubic metre	= 6.29 barrels
1 cubic metre	= 35.31 cubic feet
1 litre	= 0.22 imperial gallons
1 hectare	= 2.47 acres
1 tonne	= 2 205 pounds
1 kilometre	= 0.62 miles

March 24, 1988

The Honourable
Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

Dear Minister:

On behalf of the Board of Directors, I am pleased to present Petro-Canada's Annual Report for the fiscal year ended December 31, 1987.

In accordance with the provisions of the Financial Administration Act, the Report includes the consolidated financial statements together with the auditors' report thereon.

Yours sincerely,

W. H. Hopper
Chairman of the Board
and Chief Executive Officer

The Year in Brief

- Earnings up 40 per cent
- Cash generated from operations increased 9 per cent to $778 million
- All commonly used ratios indicating financial performance and strength improved
- Oil and gas production maintained at high levels with lower operating costs
- Second phase of Wolf Lake in situ oil sands project begun
- Terra Nova delineation drilling successful
- New automotive service franchise launched
- Integration of two refineries announced
- Continued emphasis on operating efficiency including extensive computerization in wholesale and retail marketing
- Olympic Torch Relay delighted millions of Canadians, building support and customer loyalty for the Corporation

Consolidated Financial Highlights

	1987	1986
Earnings after dividends on redeemable preferred shares (millions of dollars)	172	123
Cash generated from operations (millions of dollars)	778	711
Net capital expenditures (millions of dollars)		
Property, plant and equipment	483	448
Acquisitions	—	301
Cash flow return on average capital employed (per cent)	11.3	10.7
Total assets (millions of dollars)	8 453	8 139
Shareholder's equity (millions of dollars)	3 872	3 711

Corporate Profile

Petro-Canada is Canada's national energy corporation. Formed by an Act of Parliament in 1975, it is wholly owned by the Government of Canada. Operations began on January 1, 1976. Petro-Canada operates in a commercial fashion, competing in today's oil and gas industry on the same basis as other integrated energy companies.

With assets of over $8 billion and revenue of more than $5 billion, Petro-Canada ranks eleventh in the 1987 Financial Post 500 survey of the largest industrial corporations in the country. It is also the largest Canadian-owned oil and gas company, and one of four integrated energy companies in Canada that are national in scope.

Petro-Canada is organized into two operating divisions. Petro-Canada Resources, the "upstream" business, explores for and produces crude oil, natural gas and natural gas liquids. The "downstream" business, Petro-Canada Products, refines, distributes and markets petroleum products and offers customers related goods and services.

On a typical day, Petro-Canada produces approximately 16 400 cubic metres of crude oil and field natural gas liquids and 12.3 million cubic metres of natural gas. The Corporation's straddle plants extract from pipeline natural gas an additional 6 300 cubic metres of natural gas liquids including ethane. Petro-Canada accounts for approximately 6.5 per cent of domestic oil and natural gas liquids production and about 5 per cent of domestic natural gas production. The Corporation operates more than 70 oil and gas production facilities in Western Canada.

At year-end 1987, Petro-Canada had proven reserves of crude oil and field natural gas liquids of 89.0 million cubic metres before royalties. These reserves include Petro-Canada's interests in the Syncrude and Wolf Lake oil sands projects. Proven reserves of natural gas amounted to 96.9 billion cubic metres before royalties.

Petro-Canada also has significant probable reserves off Canada's East Coast and in the oil sands areas of Alberta.

Petro-Canada holds interests in 12 crude oil, natural gas liquids and refined products pipelines. It is operator of nine pipelines with a total throughput capacity of 78 000 cubic metres per day.

The Corporation sells over 45 million litres of refined products to 650 000 Canadians each day. The Petro-Canada brand is the top-selling gasoline in the country. A nationwide network of 3 677 retail outlets serves over 20 per cent of the market. Industrial and commercial customers are served through 38 terminals and 430 bulk plants.

Petro-Canada operates five refineries in Quebec, Ontario, Alberta and British Columbia, a lubricants plant in Ontario and an asphalt plant in Saskatchewan. With about 23 per cent of total Canadian refining capacity, these facilities can process 64 000 cubic metres of crude oil per day into a full range of high-quality petroleum products.

Chairman's Message

The year 1987 brought a measured recovery in the oil and gas business. World oil prices, which averaged about U.S. $15 per barrel in 1986, rose to an average of over U.S. $19 for 1987. Higher oil prices, improved federal and provincial fiscal regimes and the cumulative impact of dozens of efficiency-seeking initiatives combined to improve Petro-Canada's financial performance. Cash generated from operations remained strong at $778 million, up 9 per cent from the previous year. Net earnings after preferred share dividends were $172 million, a jump of 40 per cent over 1986 and the highest in the Corporation's 12-year history.

Following expenditure and staffing cutbacks in response to the oil price collapse of 1986, Petro-Canada entered 1987 as a lean and tightly focused organization. Among employees, there was a clear understanding of the Corporation's overall direction. The year's results demonstrate the power of both teamwork and individual creativity. Strategies and operating plans developed during 1986 were adjusted to meet the opportunities and challenges of 1987 – firming oil prices, an upturn in refined product demand, lower prices for natural gas, and changes in taxation and royalty structures.

In upstream operations, revenue from existing assets was increased while operating costs were tightly controlled. Productivity was improved, especially in the larger, older producing properties in Western Canada.

More emphasis was placed on natural gas. Over the year the exploration, development and marketing components of the business were strengthened to take full advantage of future market opportunities.

We also developed oil sands opportunities and selectively invested in the East Coast offshore. Encouraging results from delineation drilling at the Terra Nova oilfield, off Newfoundland, led to extensive reservoir evaluation and engineering studies in anticipation of a proposal for development. Work proceeded on phased expansion of the Wolf Lake in situ oil sands plant and the Syncrude oil sands mining project.

Cash generated from operations was strong at $778 million, up 9 per cent from the previous year.

In downstream operations, our efforts to meet customer needs and secure greater brand loyalty were intensified. Across retail and wholesale networks, we unveiled or more extensively implemented a number of marketing initiatives, some of them unique to Petro-Canada. To reduce costs we announced plans to integrate two refineries in Western Canada and creatively employed computer technology in wholesale and retail operations.

Carrying out these initiatives meant an increase in capital investments in 1987 to $483 million, up 8 per cent from 1986. Investment opportunities were made more attractive by improvements in current and expected business conditions. Spending decisions differed from those taken during most of 1986, when the emphasis was on near-term cash generation. During 1987, the Corporation balanced short-term initiatives with those that would contribute to improved financial performance and corporate growth in the medium to long term.

As a result of these actions, Petro-Canada remains a strong commercial performer with excellent prospects for future growth. Our major

position in both the upstream and downstream businesses provides operational and financial synergies, while the Corporation's enviable position in oil and gas development projects in the coming years gives us unrivalled opportunities.

All of Petro-Canada's commonly used measures of financial performance and strength improved, demonstrating our commitment to sound financial management. While we look forward to the challenges which will result from decisions to proceed with frontier or oil sands developments, we recognize that Petro-Canada will require significant external financing when it embarks on such major projects.

The year ended with yet another reminder of the volatility of world oil prices. Concern in the market over the results of a mid-December meeting of OPEC ministers led to renewed price erosion, including a rapid U.S. $3 per barrel price drop. These changes did not seriously impact the Corporation's results for 1987. However, Petro-Canada will re-evaluate its plans if prices do not return to the U.S. $18 to $21 per barrel range.

All of Petro-Canada's commonly used measures of financial performance and strength improved.

Petro-Canada monitors other issues which may significantly affect its businesses, such as the free trade agreement between Canada and the United States. For the most part, the energy components of the agreement reaffirm welcome trends in both countries toward deregulation in the oil and gas industry, with reliance on open market access and price-driven competition. While the agreement probably will not lead to higher short-term oil and gas exports to the United States, we anticipate that the promise of secure access to U.S. markets will raise investment levels in the Canadian oil and gas industry in the longer term.

Changes in regulatory and fiscal arrangements bear watching. The future health of the natural gas business hinges on the continuing evolution of transportation and pricing toward market-driven principles. The development of offshore oil discoveries, such as Terra Nova, depends on the conclusion of satisfactory fiscal arrangements. The lengthy delays experienced with the Hibernia development proposal demonstrate how difficult it

is, in a low price environment, to reach agreement on the details of risk sharing.

Petro-Canada's 1986 Annual Report featured a discussion of profitability in the refining and marketing business. The point was made that, since 1981, unsatisfactory returns have made it very difficult to undertake the high, ongoing investments needed to offer the range of services and quality of products that Canadians expect. The overall situation changed very little in 1987 and the long-term vitality of Canada's refining and marketing industry remains in question. Though product demand is slightly higher and some companies have made progress in eliminating surplus refining and marketing capacity, underutilization of facilities remains a problem. In addition, marketers now have to contend with more widespread intervention by a number of provincial governments in petroleum product pricing. Controls of this nature work against the long-term interest of consumers. Over time, less vigorous competition will result as industry participants are squeezed between market-driven prices for raw materials and regulated prices for finished products.

In Canada's refining and marketing industry, underutilization of facilities remains a problem.

As 1987 ended, there were significant changes to our Board of Directors. In December, Roy Deyell and James Robertson resigned from the Board. Harrison McCain also resigned at year end, after making a major contribution to the evolution of the Corporation over a seven-year period. I would like to thank these individuals for the guidance they have provided in their capacity as directors.

The truly encouraging feature of the past year has been the significant contribution of Petro-Canada's employees. Many praiseworthy examples of individual initiative and dedicated teamwork have come to my notice. More than anything, I have been impressed by the attention many employees now give to their operating style. Although oriented to profit margins and business efficiencies, it is a style that does not contemplate sacrificing employee safety, corporate responsibility or any other component of first-rate performance.

The success of the Olympic Torch Relay is the foremost example of the teamwork that generated the recovery we are pleased to describe in this report.

Most Canadians witnessed the Olympic Torch Relay as it passed their communities. Many commented to me on the energy and friendliness shown by Petro-Canada staff along the way. More than 700 employees voluntarily assisted our small Olympic Torch Relay group in organizing and carrying out the 88-day event. Theirs is the foremost example of the teamwork that generated the recovery we are pleased to describe in this report.

W. H. Hopper
Chairman of the Board
and Chief Executive Officer
March 24, 1988

New Dynamics in Canada's Natural Gas Business

The natural gas business represents a major opportunity in the Canadian energy field. The gas industry is currently in transition, emerging from a protective yet restrictive web of regulations. While producers' revenues are disappointingly low today, reflecting weak export volumes and low prices, the outlook nonetheless appears bright. Projections for the next few years show the current gas surplus will end, leading to higher prices and greater export sales. Carefully planned investments today will let Canadian producers capture the benefits to come from market-driven prices and increased demand for Canadian gas.

Natural gas is a North American business

The Canadian natural gas industry is best viewed in a North American context. There are several reasons for this, and they hinge on the nature of the commodity. At today's prices, the only way natural gas can be transported is through pipelines. More exotic transportation options, such as liquefied natural gas shipping, are not economically feasible now or in the foreseeable future. This makes the United States the logical market for surplus Canadian supplies.

In total, there should be sufficient Canadian and U.S. supply to meet market demand in both countries in the near and medium terms. Canada's frontier gas resources will provide ample supplies in the longer term as well. For Canadian producers, sales volumes and prices will increasingly be determined more by continental supply and demand forces than by regulation.

Canada has abundant supplies

Canada has large proven and potential gas supplies in both the Western sedimentary basin and in frontier regions. Canada's remaining established gas reserves have consistently grown over the last 20 years. Our reserves life index, defined as the number of years it would take to consume current reserves at today's rate of production, has been high and stable. In 1987 Canada had roughly a 25-year supply available from established reserves of 73 trillion cubic feet (Tcf). With frontier discoveries included, the reserves reach 97 Tcf and have a life index of 36 years.

The demand for Canadian natural gas has grown consistently and was about 1.8 Tcf in 1987. Exports, which had been decreasing in recent years from about 1 Tcf in 1979 to about 750 billion cubic feet in 1986, increased to about 1 Tcf in 1987. The decreases have reflected U.S. gas surpluses, the relatively high and inflexible prices of Canadian exports, and U.S. regulatory actions which have placed Canadian gas at a competitive disadvantage.

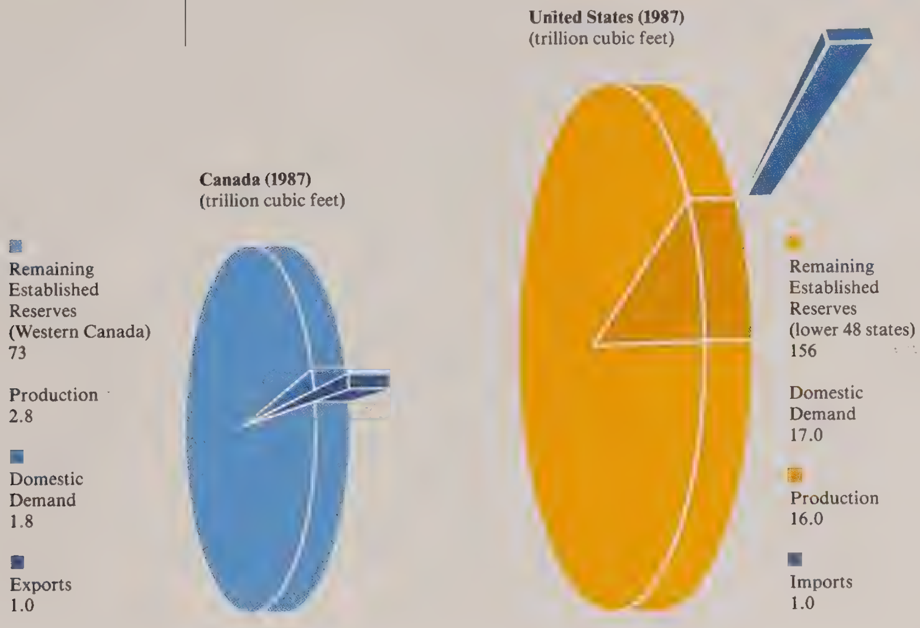
The U.S. gas market is immense

By Canadian standards, the U.S. natural gas market is very large. In 1987 consumption was about 17 Tcf, almost 10 times Canadian demand. The U.S. appetite for gas has, however, been shrinking in recent years; in 1979 it was approximately 20 Tcf. Most of the slippage has been in the industrial and electrical generation sectors. Conservation and a decline in heavy industry has reduced the size of that market, and natural gas has been displaced somewhat by low-priced residual fuel oil.

U.S. natural gas reserves are also immense, totalling about 156 Tcf in the lower 48 states. However, these reserves have declined steadily over the last 20 years as reserves additions have failed to replace production. This trend slowed with the introduction of the U.S. Natural Gas Policy Act of 1978,

Canada is fortunate to have abundant supplies of natural gas.

Estimated natural gas reserves in Western Canada will last approximately 25 years at current rates of consumption; the United States (lower 48 states) has an estimated 10-year reserves life.



Sources: Cambridge Energy Research Associates and Petroleum Industry Research Associates, Inc

which permitted some increases in U.S. wellhead gas prices. Nonetheless, the reserves life index in the United States is short, ranging between nine and 11 years since the early 1970s.

Markets opening up

In recent years, there has been more natural gas in the United States than markets can absorb. In 1987 U.S. gas wells produced 16 Tcf, though they were capable of delivering about 19 Tcf. In Canada there was a similar "deliverability surplus" of approximately 2 Tcf in 1987. As a result of these excess supplies, referred to in the United States as the "gas bubble," North American gas markets have recently been intensely competitive and prices have been depressed.

However, most observers believe the current U.S. gas surplus will dissipate over the next few years, so that domestic supplies will need to be supplemented by increased imports in the early 1990s. The decline in U.S. gas demand is expected to end. Slight demand growth could return, as new uses in the industrial and electrical generation sectors offset modest declines in gas use by traditional industrial customers. U.S. production is expected to continue to decline, particularly since current low prices discourage natural gas exploration.

Opportunities for Canadian exporters

An end to the U.S. gas surplus should have a favorable impact on Canadian gas producers, in terms of both prices and sales volumes. When available supplies more closely match demand, the price should rise to approximate the price of natural gas substitutes in the market place, primarily residual fuel oil.

The size of the U.S. gas market means even a small increase in U.S. import requirements would have a major impact on Canadian sales. Canadian exports could reach 1.5 Tcf by the early- to mid-1990s. Even with

this 50 per cent increase in sales, Canadian gas would still supply less than 10 per cent of the total U.S. market. Such an increase appears quite consistent with the availability of established Canadian supplies, given anticipated prices and expected Canadian requirements. The existing pipeline capacity can handle this level of exports, and the U.S. regulatory environment is expected to be increasingly favorable to Canadian gas imports as U.S. needs increase.

Revenues are currently depressed

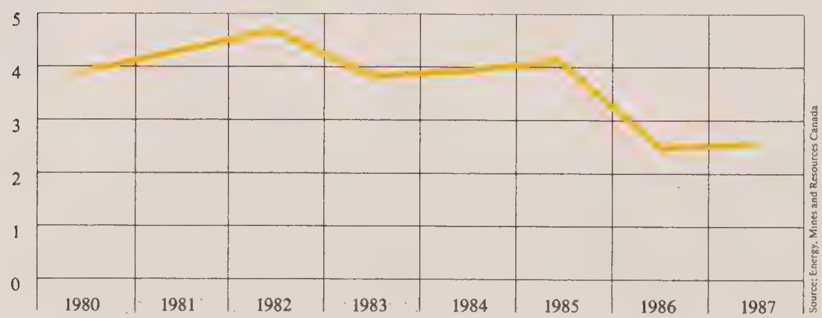
Although the future appears promising, there are a number of major challenges faced by the Canadian natural gas business. Perhaps most fundamental is planning investments for the future at a time when producer revenues are low. In 1987 gross export revenues stood at $2.6 billion, scarcely more than half the 1982 level of $4.8 billion.

The revenue drop has resulted from both lower natural gas prices and reduced export volumes. The average Canadian/U.S. border price decreased from a high of Cdn. $6 per thousand cubic feet (Mcf) in 1982 to $2.60 in 1987, a drop of over 50 per cent. Gas prices were forced down to remain competitive with cheaper oil supplies available during the 1980s. In addition, deregulation at a time of natural gas surplus led to intense competition between gas suppliers as contracts expired or were renegotiated. This competition is illustrated by the growing U.S. spot market, which has risen in just a few years from almost nothing to over 50 per cent of total U.S. sales in 1987. During the year, the spot price of gas averaged about Cdn. $2 per Mcf, 70-80¢ below the equivalent price for heavy fuel oil.

The drop in the price of gas has led to proportionately larger decreases in the price received by Canadian producers, referred to as the "netback". This situation arises because the cost of transportation, a significant component of the price, has been stable. On the upside, the reverse is also true. As prices increase, producers' netbacks will grow by a larger proportion.

Deregulation at a time of substantial surpluses has also worked against Canadian gas export volumes, which until recently have dropped more rapidly than has U.S. domestic demand. As demand declined, interstate pipelines tended to accept supplies from U.S. rather than Canadian producers. "Take-or-pay" clauses in contracts meant that pipeline companies would have to pay for the U.S. volumes even if they did not take them. For gas producers, reduced revenues over the last several years caused unexpectedly low returns on previous investments and serious drops in cash flow. Under such circumstances, it is difficult for many companies to undertake aggressive exploration programs.

Export revenues received by Canadian gas producers have declined ($ billions)



The trend toward deregulation

Extensive regulation has been a characteristic of the Canadian natural gas business since the late 1950s. At that time, the federal government decided it was in the national interest to provide for a broad domestic gas market. With subsidies given to build a pipeline connecting Western producers with central Canadian consumers, governments proceeded to control prices and collect revenues from the ensuing business.

In the early 1970s, the industry was characterized by very low regulated prices. By the middle of the decade, gas was significantly underpriced compared to oil, contributing to a growing concern about the potential for serious supply shortages in both Canada and the United States. Major shifts in government policy in both countries reflected these concerns, and led to higher gas prices, further exploration and increased supply.

With declining oil prices and falling energy demand in the early 1980s, artificially high gas prices resulted in the surplus that characterizes North American gas markets. Responding to this problem, governments began to dismantle the regulatory framework. In 1984 the uniform border pricing system for natural gas exported to the United States ended. For the first time since the mid-1970s, Canadian producers were allowed to negotiate directly with U.S. buyers, subject to certain conditions.

An agreement was reached in October 1985 between the Canadian federal government and the governments of the gas-producing provinces of Alberta, British Columbia and Saskatchewan on further deregulation. By November 1, 1986, the agreement effectively moved the industry from government-administered prices to a market-oriented price regime for both domestic and exported natural gas. More streamlined and flexible regulatory procedures, including fewer restrictions on exports of Canadian gas, have provided lower prices for consumers and improved market access for producers. Subsequent regulatory changes at federal and provincial levels have been designed to supplement the 1985 natural gas agreement. In September 1987 the National Energy Board eliminated its surplus test, a formula that determined allowable gas export volumes. The new system combines the export application process with regular monitoring to safeguard future Canadian gas requirements.

Deregulation has also occurred in the U.S. natural gas industry. Several decisions by the Federal Energy Regulatory Commission have had the effect of increasing competition, allowing brokers and marketers to arrange sales and transportation of natural gas, and changing the role played by interstate pipelines. Progress toward open-access transportation has encouraged the growth of the spot market and attempts by purchasers to modify long-term gas contracts that typically include take-or-pay clauses.

The new world of deregulation

Deregulation – permitting the price of gas to be determined by market forces rather than government policy – is a positive development for the Canadian gas industry. It has been almost universally applauded by consumers, producers and governments. In the past, producers simply sold the gas they found to pipeline companies at prices set by governments. Under deregulation, gas can increasingly be sold to anyone willing to buy it, including end-use customers, at prices determined through negotiation. These institutional changes require significantly different approaches to the gas business, and involve different risk and reward trade-offs than in the past.

In Canada, most deregulation issues have been resolved, though a few particularly difficult problems remain. Currently under discussion is pricing for the residential, commercial and small industrial customers termed the "core" market. This is a complex issue involving the interpretation of the 1985 Federal/Provincial Agreement on Natural Gas Markets and Prices and the treatment of existing contracts. Most core customers are currently served by previously negotiated long-term contracts between local distribution companies and major shippers, which in turn are backed up by contracts between shippers and producers. Although these contracts have been recently renegotiated to yield lower prices for consumers, it has been suggested that prices would be even lower if existing contracts were voided and core customers were permitted to negotiate directly with producers.

As deregulation unfolds, Canadian producers are working hard to obtain what the process promises – equal access to U.S. customers. The U.S. Federal Energy Regulatory Commission has established a voluntary program for U.S. interstate pipelines to become open-access natural gas carriers for third parties. Unfortunately, the response has been slow. To date, only one U.S. interstate adjacent to the Canadian border can be considered open access. This situation reflects the surplus of gas in the United States, and the existence of significant take-or-pay difficulties between most interstates and U.S. domestic producers. The extent and timing of open access for Canadian gas producers to the major U.S. gas markets remain to be seen.

Gas producers assume risks

As they look ahead toward opportunities presented by deregulation and a shift in the balance between supply and demand, producers have decisions to make. While there are markets that look profitable, there are many risks that must be borne in order to reach them.

Canadian natural gas resources are plentiful. However, finding new reserves, developing fields, building production, gathering and processing facilities, and finally, linking with and negotiating access to major pipeline systems is complex, time-consuming and expensive. On average, this process takes from four to seven years. There is therefore a significant gap between high front-end expenditures and the receipt of revenues.

During the time lag between investments and revenues, both sales volumes and prices will be affected by many factors. These will include the level and volatility of world oil prices, U.S. and Canadian economic activity, conservation and substitution initiatives, evolving government policies, and the supply response of U.S. gas producers as prices begin to rise.

These risks are manageable. Canadian gas producers are assessing the match between their assets and the potential offered by newly opening markets. Management teams are developing strategies that will make the most of growing investment opportunities in the natural gas business.

A stronger natural gas business

The Canadian natural gas industry is attracted by prospects of more stable North American natural gas demand and open access to U.S. markets, coupled with rising prices and declining U.S. supply. Recent downward trends in export revenues should rebound and encourage new Canadian investments. With its large reserves and developed infrastructure, Canada is capable of supplying North American markets with increased gas volumes for many years. Improved export markets and revenues will encourage exploration and development, helping ensure ample, competitively priced gas supplies for Canadian customers. At a time when weak world oil prices place some limits on opportunities in oil exploration and development, the strengthening of the natural gas business will add welcome vitality to the Canadian oil and gas industry.

A promising business for Petro-Canada

Petro-Canada is currently a major player in Canada's natural gas industry. Using latest published data, the Corporation ranks third in proven reserves and fourth in production. It operates 16 gas processing facilities and is a partner in 34 other gas processing plants in the Western provinces. In British Columbia, the Corporation is the industry leader.

Petro-Canada is also a major producer of valuable natural gas by-products. It is part-owner of two natural gas liquids straddle plants, one at Empress, Alberta, and the other at Taylor, British Columbia.

In addition to its reserves position in Western Canada, the Corporation has made significant discoveries of natural gas in the Arctic and East Coast offshore. Petro-Canada owns 52.7 per cent of Panarctic Oils Ltd., the principal explorer in the Arctic Islands over the last 20 years.

Prospects of higher returns in the natural gas business have led Petro-Canada to compete aggressively in the domestic and export sales markets. The Corporation's gas marketing capability has been significantly strengthened and greater attention has been given to gas exploration and development.

The Corporation's strength in the business today, its position in the major opportunities of the future, and its strategic thrust toward a greater emphasis on gas point to a promising future in the industry.

Resources Division

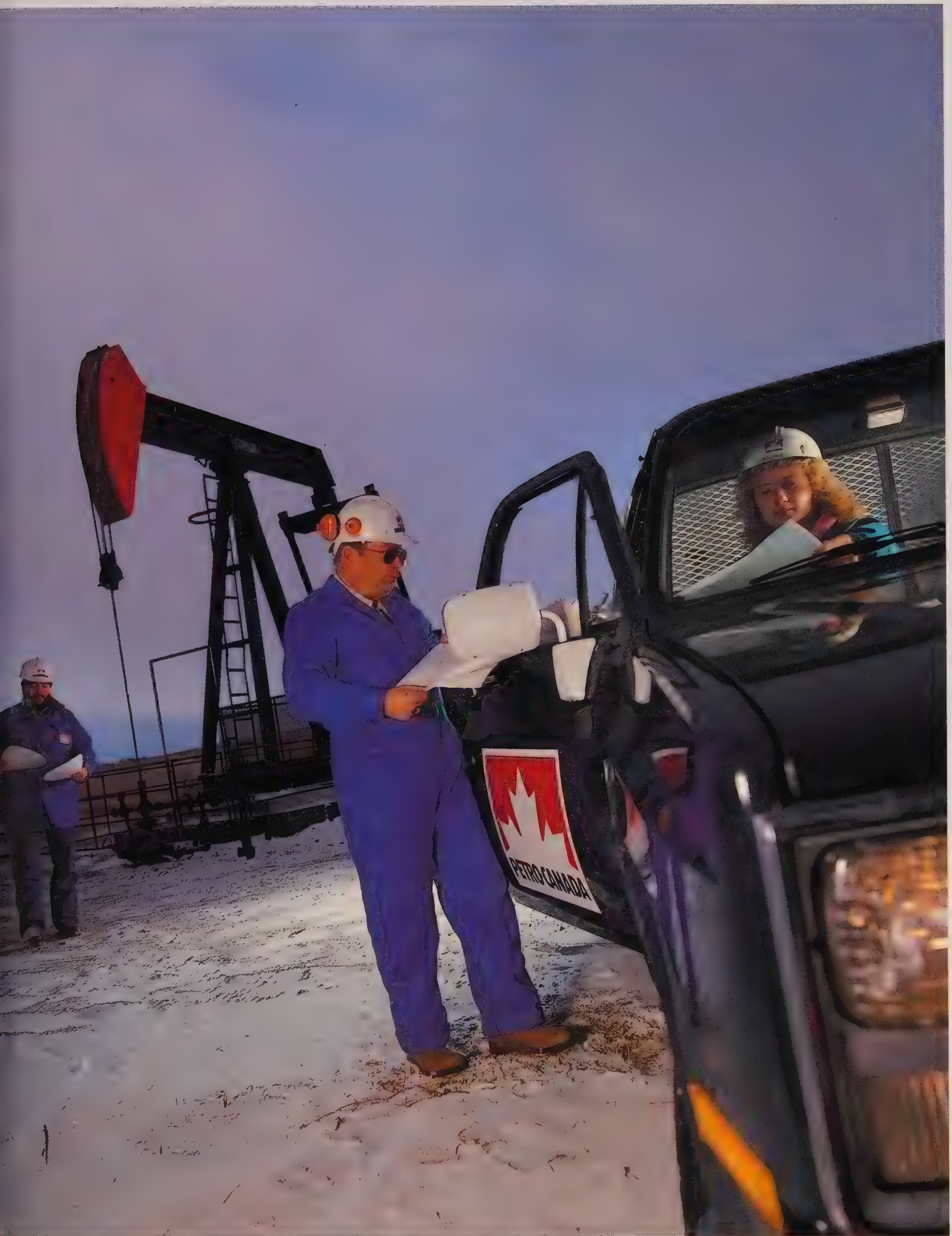
- Earnings almost tripled over 1986
- Petro-Canada captured the benefits of firming oil prices by keeping production at high levels and cutting costs

Financial and Operating Profile

Financial	1987	1986
Revenue (millions of dollars)	1 138	1 080
Earnings (millions of dollars)	162	57
Cash generated from operations (millions of dollars)	563	399
Net capital expenditures (millions of dollars)	336	316
Average capital employed (millions of dollars)	4 155	4 104
Cash flow return on average capital employed (per cent)	13.9	10.0

Operating	1987	1986
Crude oil and field natural gas liquids production, net before royalties (thousands of m³ per day)		
Conventional crude oil	10.1	10.1
Synthetic crude oil	3.7	3.5
Bitumen	0.5	0.6
Field natural gas liquids	2.1	2.1
Total	16.4	16.3
Natural gas production, net before royalties (millions of m³ per day)	12.3	10.2
Natural gas liquids production from straddle plants including ethane (thousands of m³ per day)	6.3	6.5
Proven reserves of crude oil and natural gas liquids, net before royalties (millions of m³)	89.0	90.1
Number of years of production of crude oil and natural gas liquids represented by remaining proven reserves	15	15
Proven reserves of natural gas, net before royalties (billions of m³)	96.9	96.7
Number of years of production of natural gas represented by remaining proven reserves	22	26

Bellshill Lake is Petro-Canada's top conventional oilfield. Superintendent John Hawkins and system analyst Lori Clipperton use computerized data to fine-tune production operations.



In 1987 the Resources Division recovered from the difficult year experienced in 1986. Earnings reached $162 million, nearly three times the $57 million for the previous year. Cash generated from operations amounted to $563 million, up 41 per cent from $399 million in 1986. Cash flow return on average capital employed was 13.9 per cent, up from 10.0 per cent in 1986.

Western Canadian conventional operations remained central to the Division's results. Production was maintained at high levels, allowing the Corporation to capture the benefits of stronger world oil prices. The oil price increase accounted for much of the revived earnings performance and offset the effect of weaker natural gas prices. Higher profits also reflected the impact of improved fiscal terms enacted by governments and productivity initiatives implemented during the year.

In late 1986, governments responded to the dramatic declines in oil and gas prices by removing the Petroleum and Gas Revenue Tax and making other royalty and tax changes. These changes had the effect of improving unit production margins in 1987 to levels close to those prevailing in 1985 when prices were about U.S. $30 per barrel.

To contribute to the Corporation's financial performance objectives, the Resources Division followed carefully devised strategies that recognize the Corporation's breadth and balance and need for long-term growth. These strategies involve incrementally developing in situ and mineable oil sands, selectively investing in offshore and international prospects, placing more emphasis on natural gas, and optimizing revenues from existing assets. Though the focus of capital spending was on Western Canadian conventional operations, developing future opportunities also required investments.

Actively pursuing oil sands development

In 1987 the Corporation moved forward with phased development of in situ oil sands and expanded activity in mineable oil sands.

At the Wolf Lake project, in east-central Alberta, construction began on a second phase of development. Petro-Canada has a 50 per cent interest in this partner-operated, commercial in situ oil sands project. Gross daily production capacity will increase from 1 300 cubic metres to about 3 300 cubic metres by late 1989, resulting in lower overall unit operating costs. Increased revenues will total approximately $70 million per year at 1987 bitumen prices.

The second phase involves the addition of 250 wells by 1989 plus approximately 50 wells in each subsequent year through the life of the project. The central steam generation and production handling facilities will also be expanded. Total capital costs for the 25-year project are estimated at about $750 million in 1987 dollars, including pre-production costs of about $200 million. Some 360 workers will be employed at the peak of construction and approximately 40 permanent jobs will be created when the expansion is fully operational. In 1988 Petro-Canada and its partner are planning to test a pilot combustion project designed to boost bitumen recovery rates.

The Syncrude oil sands mining project achieved its third consecutive year of record production. Petro-Canada has a 17 per cent interest in the project and serves on its management committee. In 1987 Petro-Canada's share of production was 3 700 cubic metres per day, yielding revenue of $201 million, up 17 per cent from 1986. Production will increase by 14 per cent with the completion of the capacity addition project in 1990. Currently, the Syncrude plant produces about 11 per cent of Canada's crude oil.

Syncrude management has reduced unit operating costs about 40 per cent in as-spent dollars since the early 1980s. Greater efficiency has resulted from improved operating practices and modifications to equipment. For example, the planned interval between major maintenance turnarounds for the two coking facilities has been increased to 18 months, and the duration of the shut-down period has been reduced.

During 1987, the Syncrude participants proceeded with engineering work to determine the feasibility of a $4 billion plant expansion which would increase production capacity by a further 50 per cent. These studies will continue during 1988 with support from the Government of Alberta.

Petro-Canada has large landholdings in both in situ and mineable oil sands and routinely evaluates development opportunities. The Corporation and five other participants began discussions with governments during the year on the feasibility of a $4 billion oil sands mining project known as OSLO. Located at Kearl Lake, near Fort McMurray, the project lease

The Wolf Lake in situ oil sands operation is being expanded to more than double its production. Petro-Canada is a 50 per cent partner in the project.

contains large, high-quality deposits. In addition, Petro-Canada continued its involvement with several in situ test facilities in northeastern Alberta.

Selectively investing in offshore and international prospects

The Corporation focused its 1987 East Coast offshore activity on the most promising development opportunities.

On the Grand Banks, Petro-Canada drilled a delineation well in the Terra Nova oilfield where the Corporation holds a major interest and is the operator. The well, which was tested in November, generated very encouraging results, confirming field reserve estimates. With improved production prospects, Petro-Canada now has increasing confidence in the feasibility of a Terra Nova development project. In December, Petro-Canada began a seventh delineation well. Work on development alternatives involving floating production systems began during 1987 and will be completed at the end of 1988. Current plans indicate that, given continued drilling successes and timely regulatory approvals, construction could begin by 1991.

Eventual production from the Terra Nova oilfield off Newfoundland moved closer following successful testing at the H-99 delineation well.

In August, Petro-Canada completed a delineation well in the Panuke field, 250 kilometres east of Halifax. During testing, a tanker load of oil recovered from the well was shipped to Petro-Canada's Montreal refinery for commercial processing. Reserves found to date are relatively small for an offshore development.

Discussions with partners and governments continued during 1987 on the development of the Hibernia oilfield off Newfoundland, though fiscal terms remained unresolved at year end. Petro-Canada is committed to participate in the development should negotiations lead to an agreement.

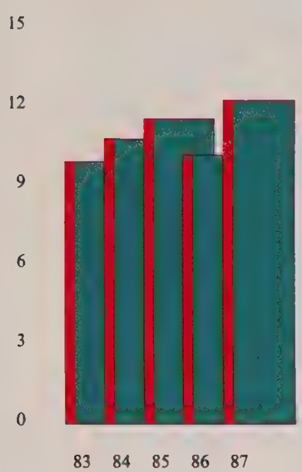
In 1987 the Corporation reduced frontier land expenditures. Only those frontier landholdings containing significant discoveries or possessing definite medium-term exploration potential were retained. As a consequence, exploration rights were relinquished in large areas off the East Coast and in the North.

During the year, Petro-Canada increased its emphasis on international programs. Given the likelihood that weak world oil prices will lead to the deferral of many Canadian oil and gas projects, the Corporation is examining a number of attractive international opportunities for the exploration and development of inexpensive reserves. As operator, Petro-Canada led two exploration ventures in Colombia and one in Papua New Guinea; work undertaken in 1987 consisted of geological, geophysical and drilling activity. After being awarded a service contract for operations in the Oriente region of Ecuador, Petro-Canada established in Quito its first foreign office. Petro-Canada also participated in exploration ventures in Indonesia, Spain and Colombia. Revenues of $21 million were received from production at the partner-operated Casablanca oilfield in offshore Spain.

Increasing emphasis on natural gas

As expected, surplus natural gas supply and declining prices depressed the financial performance of the natural gas business. Petro-Canada's production at 12.3 million cubic metres per day was up over 1986, but the average field-gate price received for natural gas fell from about Cdn. $2.10 per Mcf in

Natural gas production,
net before royalties
(millions of m³ per day)



1986 to $1.60 in 1987. This meant that even though production rose, revenues were lower than in the previous year.

In spite of this situation, Petro-Canada took a number of steps to gain efficiencies and position itself for future market opportunities.

The Corporation strengthened its natural gas marketing capability. Currently, 4 per cent of Petro-Canada's production is used in direct sales, 23 per cent goes to internal markets and 73 per cent is handled by Canadian shippers. During the year, direct sales contracts were renewed with three B.C. industrial end-users, and the Corporation made its first direct spot market sale to an industrial consumer in the U.S. Pacific Northwest. Petro-Canada also completed arrangements to increase gas supplies to internal markets including, for the first time, the Montreal refinery.

Additional natural gas sales continue to be hindered by complex regulatory requirements, specifically in pipeline transportation. Petro-Canada took steps to secure long-term, contracted transportation services in British Columbia to facilitate the future movement of its gas to market.

During the year, some previously unconnected reserves were tied in, such as the Pembina Keystone and Chard fields in Alberta. Productivity at producing fields was also increased through facility improvements.

In December, Petro-Canada and its partners requested approval from the Alberta Energy Resources Conservation Board for an $89 million expansion to the Brazeau sour gas facility which the Corporation operates in west-central Alberta. Petro-Canada and its partners will participate in public hearings in 1988. The expansion will include additional production wells and an enlarged gathering system. Expected to come on stream in late 1989, it will increase Petro-Canada's share of natural gas processing capacity 140 per cent

John Birt of Skeena Cellulose Inc. and Jerry van der Linden, Petro-Canada's manager of natural gas market development, watch as bales of pulp are prepared for shipment. Petro-Canada supplies gas directly to the Skeena Cellulose pulpmill at Prince Rupert, British Columbia.

Lori Clipperton, project system analyst in Calgary, monitors data from field locations across Alberta. The new, integrated production data system provides a single computerized data base from which production operations are managed.

to 700 000 cubic metres per day. At current prices, Petro-Canada's share of additional revenues will be $8.5 million per year.

In October, a six-inch pipeline was completed between Petro-Canada's wholly owned Petroleum Transmission Company pipeline and the Cochin pipeline near Regina, Saskatchewan. The $1 million investment enables liquefied petroleum gas to be shipped more economically and with greater flexibility from the Corporation's Empress straddle plant to markets in Central Canada and the United States. During the year, Petro-Canada also improved transportation access on the Cochin pipeline to the petrochemical market in Sarnia, Ontario; this in turn helped strengthen demand for propane produced at Empress.

Optimizing revenues from existing assets

The upstream business is largely driven by external forces, especially world oil prices. Success hinges on increasing margins through finding better ways to use existing assets and minimize costs.

Based on the experience gained at six test locations in 1986, Petro-Canada effected major changes in the management of Company-operated oil and gas fields in Western Canada. By year end, a management approach characterized by integrated reservoir and production management teams had been implemented at 16 of Petro-Canada's major fields. A typical team consists of supervisory and working-level representatives from reservoir, production and facilities engineering, and the operations group. Their goal is to balance short-term demands for maximum volume with the longer-term need to manage reserve depletion.

Petro-Canada's top revenue-generating conventional field, at Bellshill Lake in east-central Alberta, illustrates the approach. The Bellshill Lake team conducted plant and field capacity testing and used the results to lower operating costs and maximize lifting capability with the existing equipment. The team also designed and implemented, within just six months, a $6.5 million, 17-well infill drilling program that increased total field oil

production by 9 per cent. The same approach has been adopted at some of the Corporation's smaller fields. At the Kobes gas field in northeastern British Columbia, one such team significantly increased production by undertaking additional drilling, installing compression with state-of-the-art equipment, and building new facilities.

In numerous instances, individual employees proposed cost control and margin improvement programs. While most initiatives were relatively small, the cumulative effect reached approximately $11 million.

Well performance was enhanced at Petro-Canada's Cactus Lake and Salt Lake heavy oil fields in Saskatchewan. A unique concept using produced gas to fuel pump motors eliminated the need for large quantities of propane. These modifications gained yearly savings of approximately $500 000. In another instance, staff replaced the conventional steel rods used to pump oil from the Utikuma oilfield in north-central Alberta. Made of fibreglass, the new rods are lighter and more flexible and have resulted in lower operating costs and a 70 per cent increase in oil production.

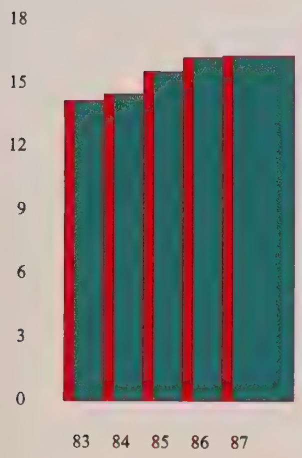
Work at the Smiley oilfield in western Saskatchewan was an example of facility optimization. The installation of a compressor made it possible to lower pressures in the field gathering and processing system while maintaining sales of associated gas to a local utility at contracted pressures. The lower system pressures enabled more oil to flow into the well bores, increasing total production from the field by 10 per cent.

Certain changes in business procedures also led to higher profits. An example was the implementation of a computer system to monitor electrical purchases for production facilities. When fully operational in the spring of 1988, the system will streamline procedures, compare actual with budgeted billings and flag excessive expenditures. By year end, it was already evident that systematic management of purchases could reduce total electricity expenditures by about $800 000 per year.

Computerization enabled Petro-Canada to begin an integrated production data system. This system will reduce costs over the longer term by facilitating quicker responses to operating problems as well as more efficiently meeting external reporting requirements.

During 1987, production, drilling and engineering groups in Western Canada implemented a comprehensive loss control program. An international rating system is being used to improve working conditions, reduce losses and heighten awareness of personal and equipment safety. Results for the year included the development of a computerized loss event reporting program, investigation and analysis of losses, and the design, implementation and evaluation of preventive measures. Compared to 1986, revenue losses and other costs due to interruption of operations, equipment damage and preventable accidents dropped by 50 per cent. Disabling injuries were halved and preventable vehicle accidents were down by about 45 per cent.

Crude oil and field natural gas liquids production, net before royalties (thousands of m^3 per day)



Products Division

- Earnings and margins squeezed by price cutting in wholesale and retail markets
- Focus on strengthening customer loyalty while reducing operating costs

Financial and Operating Profile

Financial	1987	1986
Revenue (millions of dollars)	4 461	4 588
Earnings (millions of dollars)	95	115
Cash generated from operations (millions of dollars)	330	346
Net capital expenditures (millions of dollars)		
Property, plant and equipment	122	112
Acquisitions	—	301
Average capital employed (millions of dollars)	2 757	2 846
Return on average capital employed (per cent)	3.4	4.0

Operating	1987	1986
Petroleum product sales (thousands of m^3 per day)	45.6	44.4
Number of retail and wholesale marketing outlets	4 268	4 344
Refinery crude capacity (thousands of m^3 per day)	64.0	64.0
Crude oil processed by Petro-Canada (thousands of m^3 per day)	48.4	47.2
Refinery utilization (per cent)	76	74

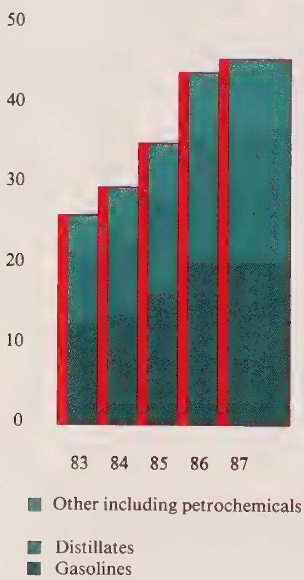
Petro-Pass is Canada's number one truck fuelling network. The system offers truckers convenient, round-the-clock card-activated access to fuels and lubricants at 104 locations across Canada.

Results for the Products Division in 1987 were limited by several external factors. As a consequence, earnings of $95 million were down 17 per cent from a year earlier. Cash generated from operations amounted to $330 million, 4.6 per cent less than in 1986. Return on average capital employed was 3.4 per cent.

Although Canadian demand for petroleum products rose slightly in 1987, surplus refining and marketing capacity continued to hold industry profitability at disappointing levels. Profit margins were squeezed during 1987, particularly in the second half of the year when product prices did not fully recover rising costs, particularly for crude oil. In the fourth quarter of 1987, average product prices actually fell. In Eastern Canada, intervention in the market by several provincial governments led to ceilings or rollbacks on petroleum product prices. In Western Canada, intense competition also pushed prices below levels necessary to provide adequate returns.

For Petro-Canada, petroleum product sales increased approximately 3 per cent. Sales of gasoline were stable while sales of distillates were up slightly. Volumes of crude oil processed were up 2.5 per cent from 1986 with refinery utilization for the year averaging 76 per cent, up from 74 per cent in 1986.

Petroleum product sales
(thousands of m³ per day)



The Products Division continued to seek improvements in profitability by concentrating on four key strategies: providing superior customer service, maximizing revenues from existing marketing assets, cutting costs in refining, and seeking operating efficiencies through computerization and integration.

Placing customers first

Petro-Canada recognizes that satisfied customers are critical for earnings growth in its business. For this reason, the Corporation's downstream activities are driven by the needs of the customer.

In retail operations, Petro-Canada implemented national service standards and trained over 6 000 retailers and station attendants. A program to encourage community participation and improve image, called Club Excellence, was expanded during the year. A special President's Award was introduced to give recognition to outstanding performers. In addition, a national business associates council was established. The council will meet regularly with Petro-Canada management to improve retail operations.

Better communications with customers is a top priority. Petro-Canada introduced a toll-free customer service line linked to the Corporation's retail credit card centre. Centralized computer tracking guarantees effective management of all queries, complaints, compliments and suggestions. This service, available at year end in the Maritimes and Ontario, will be expanded nationally in 1988. Products Division management also organized customer appreciation days in cities across the country. Employees from

throughout the Division volunteered to spend a day at a service station, helping to promote Petro-Canada's products and services and gaining an appreciation of motorists' needs. These kinds of initiatives are central to building a stronger bond between Petro-Canada and its customers.

Service standards are also being strengthened in wholesale and commercial operations. For instance, new training modules were introduced, the Club Excellence program was enhanced, customer appreciation days were held at major trucking facilities, and a national business council for wholesale agents was established. In addition, two major customer-focused programs were expanded during the year.

One of these is Petro-Pass, the country's foremost truck fuelling network. This system offers truckers convenient card-activated access to fuel and lubricants throughout the country on a round-the-clock basis. At some of the outlets, special services are available such as accessory shops, showers and overnight parking. During 1987, the Corporation expanded the Petro-Pass system, adding 18 new facilities, mainly in Quebec and Atlantic Canada. By year end, Petro-Pass was a truly national network comprising 104 outlets at locations no more than 600 kilometres apart.

Petro-Canada's national fleet fuel and maintenance program was also expanded, resulting in increased sales of fuels and lubricants. Drivers of fleet vehicles can use special fleet credit cards for purchases at any one of the Corporation's retail outlets. Specialized fleet maintenance services are provided at Petro-Canada outlets designated as authorized fleet care centres. During 1987, 50 more centres were added, bringing the total to 360 across the country.

Randy Parcels, a pipeline logistics specialist in Calgary, gains a better understanding of motorists' needs while meeting the public during customer appreciation day.

Petro-Canada's focus on the customer was also demonstrated following an unexpected difficulty in lubricants production. In June, a fire caused by equipment failure resulted in severe damage to the HydroTreater refining unit at the Clarkson lubricants plant in Mississauga, Ontario. Rapid responses by the local fire department and Petro-Canada staff ensured the fire was quickly contained and that no injuries occurred. Nonetheless, the damage jeopardized Petro-Canada's ability to supply customers that relied on the quality inherent in lubricants produced through the HT process.

By bringing in partially processed product from Petro-Canada's Montreal refinery, hydrotreated base stock from foreign plants and some finished products from Canadian suppliers, the Corporation continued to supply all of its blended lubricants customers and some of its process oil customers. Those whose requirements could not be met were assisted by a Petro-Canada staff team in obtaining suitable short-term alternative supplies. At year end, construction was under way on new vessels for the HydroTreater; with startup anticipated in July 1988, Petro-Canada will resume production and delivery of a complete range of top-quality lubricants.

Increasing revenue from existing assets

To increase revenues from existing marketing assets, the Corporation sought to strengthen petroleum and petroleum-related operations. Existing programs were developed more fully and new businesses were introduced to achieve this objective.

During 1987 Petro-Canada introduced a new line of franchises in automobile maintenance and repairs. Called Certigard, it is a comprehensive

Dick Klumpenhower, a Calgary Certigard manager, discusses service requirements with a customer. Certigard is Petro-Canada's unique new personal car care business.

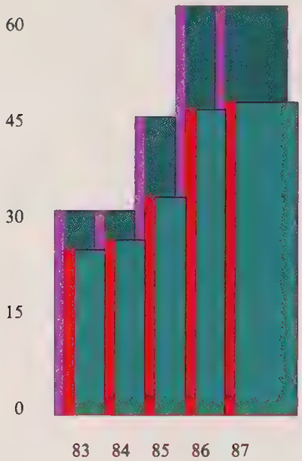
Dee Parkinson, refinery manager, and Frank Hunt, Syncrude area supervisor, review data in the synthetic crude control room of the Edmonton refinery. Petro-Canada has announced an integration of its Edmonton and Port Moody refineries.

blueprint for success in this sector, covering customer relations practices, service procedures, management systems, facilities and equipment, technical training, products and marketing. The elements are designed to work as a system to boost efficiency, and attract and retain customers by offering unmatched service. By year end, arrangements had been made to implement the Certigard franchise at 51 Petro-Canada retail outlets; further expansion will occur in 1988.

In the past, Petro-Canada has participated significantly in the convenience store market through association with national "c-store" chains. However, recognizing the potential for increased revenues by offering one-stop shopping, the Corporation is establishing its own identity in the convenience store business. By year end, 12 new stores were operating at Petro-Canada facilities under the Neighbours banner or as Le Frigo in Quebec. Sales of both convenience items and gasoline at the initial locations have exceeded expectations. The Corporation plans further development of this program in 1988.

With the premier network of tunnel car washes in Canada, Petro-Canada washes over 11 million cars a year at 200 locations. This activity generates significant revenues and also enhances the Corporation's gasoline sales. In 1987 Petro-Canada began a program to gain greater value from this asset. The Corporation is upgrading its equipment, improving its operating practices and enhancing staff training. These plans have been developed to increase loyalty and gain new customers by building on the Corporation's advantage in tunnel car washes.

Refinery capacity and crude oil processed
(thousands of m^3 per day)



Cutting costs in refining

In order to improve refinery utilization, the Corporation plans to integrate the refineries in Edmonton, Alberta, and Port Moody, British Columbia, effective in the fall of 1988. Partially processed feedstock will be shipped from Edmonton to Port Moody via the TransMountain pipeline for final processing and blending into finished products.

The decision will result in the closing of Port Moody's catalytic cracking and alkylation units. Many of the affected employees will be offered positions elsewhere in the organization.

Besides improving refinery utilization, the integration of the Edmonton and Port Moody facilities takes full advantage of Edmonton's strengths in crude refining and Port Moody's octane generation capability. The Port Moody refinery will continue to supply West Coast markets with customized gasolines, diesel fuels, heating oil and jet fuel.

Since September 1986, the Corporation has been actively engaged in a crude oil futures trading program. The primary purpose is to hedge against adverse price movements in the Corporation's basic products. This trading is conducted under carefully controlled conditions and the results are regularly monitored. By hedging the Corporation's physical barrel exposure to adverse price movements, futures trading provides relative stability in an otherwise volatile international environment.

Gaining efficiencies through computerization and integration

Following a successful pilot program in 1986, the Corporation began installing electronic credit authorization terminals at its service stations. By early 1988, the equipment will be in place at about 2 500 high-volume locations across the country and will handle most of the Corporation's annual load of 55 million credit card transactions.

Petro-Canada's customers find the system more convenient; it takes about 20 seconds to process a purchase using the credit authorization terminal, including less than six seconds to verify the card. The system also speeds up credit card billing and reduces card processing errors. The Products Division obtains savings through the freeing-up of working capital and the reduction of operating costs. With less paperwork, service station dealers benefit from improved invoice records and simplified bookkeeping.

In product distribution, continued rationalization and computerization produced further efficiencies. The improved light oil distribution system, introduced in 1986, was expanded to Quebec and the Maritimes and small centres throughout Canada. This system automates inventory control and improves delivery scheduling to company outlets and customers. In

addition, automation was begun at the Corporation's commissioned bulk outlets in late 1987. Benefits include lower requirements for working capital and improvements in order entry, delivery scheduling and inventory management.

Integration of the former Gulf marketing operations, which was largely completed in 1986, created a number of opportunities for efficiency improvements in 1987.

Multi-departmental teams standardized retail accounting, credit and distribution practices. In little more than one month, hundreds of thousands of retail accounts were converted to descriptive billing. Subsequently, retail credit cards issued by Gulf were replaced with new Petro-Canada cards. The re-identification of retail facilities was accelerated during the year and is scheduled for completion in early 1988.

Toronto area staff moved from three separate office buildings to the North York City Centre in the early part of the year. The new building now serves as the principal office for personnel located in Ontario. The improved communications and team spirit resulting from the move have led to greater operating efficiencies.

Petro-Canada is experimenting with a Canadian innovation that offers the ultimate in self service. A touch-activated laser video-screen is linked to gas pumps and speaks directly to customers, helping them dispense gasoline and allowing payment in a matter of seconds.

Corporate Responsibility

Petro-Canada works hard to develop and maintain a special relationship with the people of Canada. As Canada's national energy corporation, Petro-Canada has certain responsibilities: a focus on Canada in its business decisions, a special attention to operational safety and environmental protection, and a respect for the communities in which it does business.

This winter's Olympic Torch Relay is an excellent example of the potential that comes with Petro-Canada's identity. The Corporation's role in organizing the relay and transporting the Olympic flame across the country demonstrates the value that can be achieved from a commitment to the country and an ability to do a job well.

In late 1985, when Petro-Canada won the right to stage the torch relay for the XV Olympic Winter Games, the Corporation recognized it had made a decision that went far beyond an exercise in good corporate citizenship. Rather than simply buying a sponsorship position that could be used in marketing, Petro-Canada accepted a much greater task – to actually organize and carry out an Olympic event.

To make the most of its $6.9 million investment, Petro-Canada took the event in a completely new direction. For the first time in history, the torch relay was opened up to all people in the host country – any Canadian could apply to be one of the nearly 7 000 who would bear the torch. A route was selected that would allow as many people as possible to view the passage of the flame first-hand; 90 per cent of Canadians live within a two-hour drive of the route.

Public involvement in the Olympic Torch Relay was encouraged. To select torchbearers, invitations were sent to all Canadian homes and an independent firm was then commissioned to supervise a lottery and draw winners from the 6.7 million applications. The torch was designed to resemble the Calgary Tower and was manufactured in Canada with Canadian materials. All torchbearers were provided with colorful, high-quality running suits, custom-designed by a Calgary manufacturer.

Advertising and marketing budgets were redirected to torch relay-related initiatives. During the last two years, many millions of commemorative glasses were sold to the public, raising $4 million for an Olympic scholarship program called the Petro-Canada Olympic Torch Relay Legacy Fund.

During the 88 days that the flame passed across the country, the response of Canadians was impressive and moving. For the Corporation, the endeavor was so successful that benefits go far beyond any incremental retail sales. For the nation, new meaning has been injected into the concept of Olympic spirit. Canadians have set a new standard by which all future Olympics will be judged.

Petro-Canada employees share the flame

Petro-Canada employees began the task of organizing the torch relay in late 1985. A small management staff, reporting through the Products Division, was drawn from operating groups. Once the nature of the event was established – a relay open to any Canadian, a route spanning the country, a lottery to select torchbearers and special kilometres designated for Native and handicapped Canadians – the staff was expanded to 10 and detailed planning began.

The enormity of the task meant that relay staff frequently had to request help from other employees. For instance, each of the 11 000 kilometres travelled on land had to be carefully mapped out; volunteers repeatedly drove stretches of the route, noting landmarks and possible problems, and suggesting alternative roads to make the relay safer and more accessible for spectators.

As the Calgary manufacturer delivered the thousands of uniforms needed for the event, dozens of Petro-Canada employees gave their own time to sort and pack them into individual bags for torchbearers and caravan staff members.

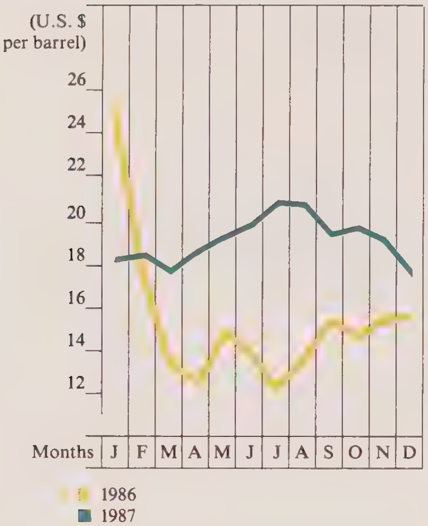
A torch was needed that would withstand high winds and frigid conditions, would burn brightly and with an orange flame, yet would be safe and relatively smoke-free for indoor ceremonies. Staff at Petro-Canada's Sheridan Park Research Centre formulated and tested the fuels for the job.

From the time the flame arrived in Newfoundland from Greece until the Opening Ceremonies in Calgary, 700 employee volunteers spent week-long shifts working on the caravan. They drove the vehicles, ran as escorts with torchbearers and, with painstaking attention to detail, coordinated the complex day-to-day logistics.

Throughout the planning and staging of the event, staff across the Corporation added enthusiasm and shared expanded workloads. In these ways, all Petro-Canada employees made a contribution to the XV Olympic Winter Games.

The 88-day Olympic Torch Relay brought the Olympic spirit to millions of Canadians.

Crude oil prices*
Crude oil prices were higher and more stable in 1987 than in 1986, but well below levels prevailing in 1985.



*based on average NYMEX prices (one-month forward) for West Texas Intermediate at Cushing

Responding to an uncertain world oil market

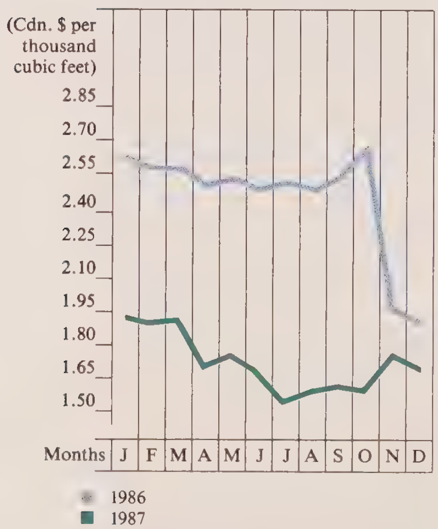
Petro-Canada's financial and operating results for 1987 were improved, largely as a result of increased prices for crude oil. In 1986, international crude oil prices dropped sharply to nearly U.S. $10 (Cdn. $14) per barrel and fluctuated for much of the year. With the introduction of deregulation in late 1986, natural gas prices also fell dramatically. As a result, oil and gas production revenues and the value of reserves remaining in the ground fell substantially in that year. During 1987, the international crude oil market was more stable and prices ranged from U.S. $16 to $22 (Cdn. $21 to $29) per barrel, averaging over U.S. $19 (Cdn. $25) for the year. Field-gate natural gas prices averaged approximately Cdn. $1.60 per Mcf in 1987 versus Cdn. $2.10 per Mcf in 1986.

Contributing significantly to Petro-Canada's improved 1987 results were the programs established during 1986 to cut costs whenever possible, downsize the organization and enhance operational flexibility.

Financial results encouraging

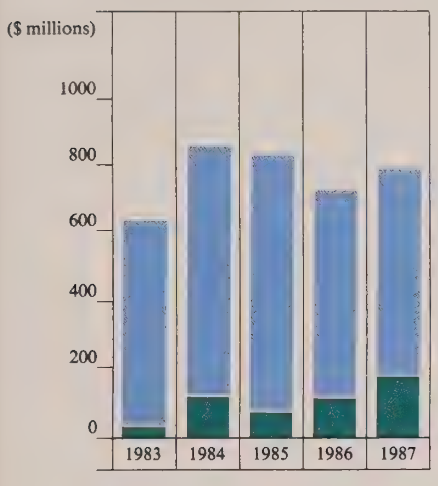
Consolidated earnings after redeemable preferred share dividends were $172 million in 1987, up 40 per cent from $123 million in 1986. Reflecting the improvement in crude oil prices and the continuing realization of efficiency measures initiated in 1986, Resources Division earnings increased from $57 million in 1986 to $162 million in 1987. Products Division earnings dropped from $115 million in 1986 to $95 million in 1987 due to a combination of factors that depressed profits in the industry. Corporate and other activities resulted in a loss of $44 million largely as a result of an increase in deferred profit in inventory due to higher crude oil prices.

Natural gas prices*
Following the implementation of deregulation in late 1986, natural gas prices declined dramatically. Prices remained under severe pressure in 1987 because of surplus supply in North America.



*based on industry average of Alberta field-gate prices

Cash generated from operations versus net earnings*
Cash flow available for the Corporation's purposes continues to be strong at $778 million in 1987. Earnings rose 40 per cent in 1987.



Cash generated from operations

Net earnings*

*after dividends on redeemable preferred shares, before extraordinary and unusual items

Cash generated from operations of $778 million in 1987 was up 9 per cent from $711 million a year earlier. Cash generated by the Resources Division increased substantially from $399 million in 1986 to $563 million. Cash contributions from the Products Division declined from $346 million in 1986 to $330 million in 1987.

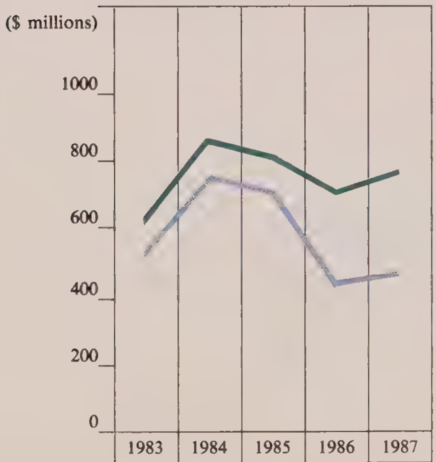
Net capital expenditures of $483 million were 8 per cent above 1986 levels, with new investment directed primarily to the Resources Division. In addition, requirements for working capital in 1987, primarily related to Products Division inventories, were $244 million compared with a reduction of working capital in 1986 of $406 million.

Average capital employed by the Corporation in 1987 amounted to $7 353 million, compared with $7 226 million a year earlier. Cash flow return on average capital employed increased from 10.7 per cent in 1986 to 11.3 per cent in 1987. This key measure of the Corporation's performance has remained very close to the level prevailing in 1985 despite the world oil price collapse.

Investment activities appropriate for current business environment

Capital expenditures were increased in 1987 with emphasis placed on investing for short-term cash flow while at the same time maintaining interests in the more promising, longer-term development projects. In particular, gross investments in the Corporation's exploration program were reduced and the focus was shifted from the frontiers to conventional oil and gas properties in Western Canada. Capital expenditures in the refining and marketing business were also limited to the extent possible during integration of the former Gulf operations. The Corporation continues to invest within the framework of

Cash flow and reinvestment
Investment in 1987 responded to improving cash flow and the more stable and attractive business climate.

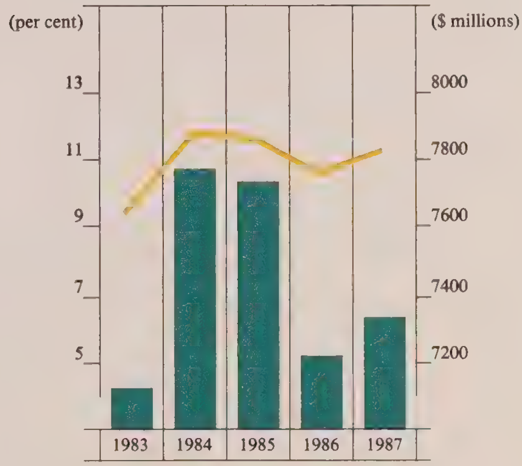


	1983	1984	1985	1986	1987
Reinvestment ratio	.85	.87	.86	.63	.62

Cash generated from operations

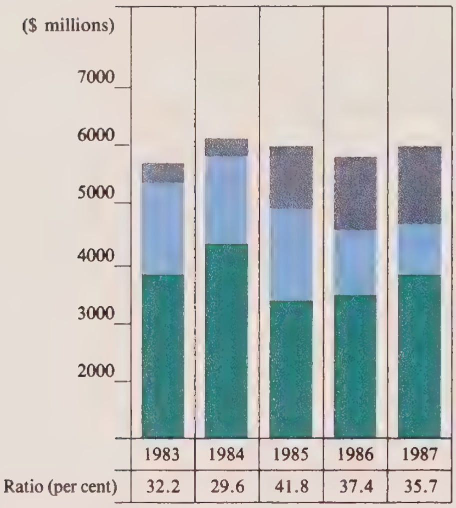
Net capital expenditures

Profitability
Cash flow return on average capital employed was sustained at approximately 11 per cent over the last two years in spite of difficult business conditions.



Cash flow return on average capital employed (per cent)
Average capital employed ($ millions)

Financial position
Debt plus redeemable preferred shares to capital, shown below as "Ratio", has averaged 35 per cent over the past five years. The ratio has steadily improved since 1985.



■ Debt
■ Redeemable preferred shares*
■ Shareholder's equity**

*valued at year-end U.S. $/Cdn. $ exchange rates
**retained earnings reflect the valuation of redeemable preferred shares at year-end U.S. $/Cdn. $ exchange rates

current and prospective levels of cash generated from operations. Gross capital expenditures for exploration and development of Western Canadian conventional oil and gas were approximately $101 million and $108 million, respectively. Spending in frontier areas was $41 million and in oil sands $79 million. Capital expenditures for refining and marketing totalled $122 million.

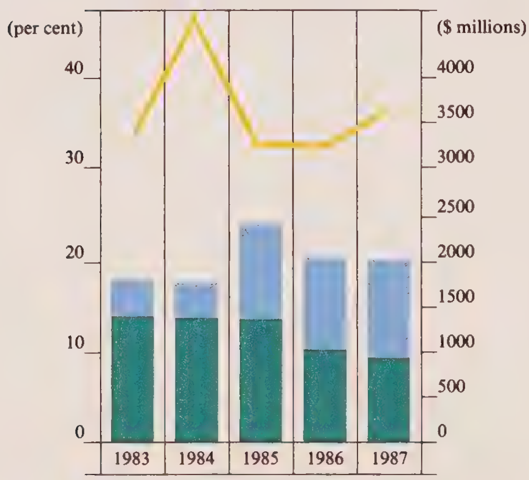
Financial structure sound

Petro-Canada's financial position remains fundamentally sound. Despite the volatile and uncertain business environment, financial coverage and leverage ratios have improved during the past two years. At the end of 1987, the Corporation's measure of debt plus redeemable preferred shares to capital declined to 35.7 per cent from 37.4 per cent at the end of 1986. Cash flow to debt plus redeemable preferred shares rose in 1987 from 33.5 to 37.0 per cent.

The Corporation remains committed to maintaining the integrity of its financial structure. Cash generated from operations continues to be sufficient to finance a significant capital program and fulfil Petro-Canada's fixed financial obligations, including both debt and the servicing of redeemable preferred shares. Dividends of $41 million paid on redeemable preferred shares in 1987 were $18 million lower than in 1986 due to lower prevailing interest rates and share redemptions. Interest expense of $73 million was $6 million higher than in 1986.

Considerable additional external financing will be required if the Corporation is to proceed with major new development projects. Given the uncertain business environment expected over the next few years and the long lead-times typical of major new developments, caution will be required. The financing of new commitments will be carefully planned to avoid undue levels of financial risk and safeguard the Corporation's financial structure.

Cash flow to debt plus redeemable preferred shares
This ratio has averaged 37 per cent during the last five years and demonstrates the Corporation's capability to manage its financial obligations.



● Cash flow to debt plus redeemable preferred shares (per cent)

■ Debt ($ millions)
■ Redeemable preferred shares* ($ millions)

*valued at year-end U.S. $/Cdn. $ exchange rates

Petro-Canada

Management's Responsibility for the Financial Statements

The financial statements have been prepared by management in accordance with generally accepted accounting principles appropriate in the circumstances. Management is responsible for the other information in the Annual Report, which is consistent, where applicable, with that contained in the financial statements. Management is also responsible for installing and maintaining a system of internal control to provide reasonable assurance that reliable financial information is produced. The Corporation has an internal audit department whose functions include reviewing the system of internal control to ensure that it is adequate and functioning properly.

The Board of Directors is responsible for ensuring that management fulfils its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, a majority of which is composed of directors who are not employees of the Corporation. The committee meets with management, the internal auditors and the external auditors to satisfy itself that responsibilities are properly discharged and to review the financial statements.

The external auditors conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their examination includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board.

Auditors' Report

To the Honourable
Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

We have examined the consolidated balance sheet of Petro-Canada (incorporated by Special Act of the Parliament of Canada) as at December 31, 1987 and the related consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1987 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change (with which we concur) in the method of accounting for pension plans as explained in Note 14 to the consolidated financial statements, on a basis consistent with that of the preceding year.

We further report that, in our opinion, the transactions of the Corporation and its consolidated wholly owned subsidiaries that have come to our notice in the course of our examination of the consolidated financial statements of Petro-Canada were, in all significant respects, in accordance with the Financial Administration Act and the regulations thereto, the charter and by-laws of the Corporation and its consolidated wholly owned subsidiaries and any directives given to the Corporation.

Calgary, Alberta
February 23, 1988

Arthur Andersen & Co.
Chartered Accountants

Petro-Canada

Consolidated Balance Sheet

As at December 31, 1987
(stated in millions of dollars)

Assets	1987	1986
Current Assets		
Cash and short-term deposits	$ 10	$ —
Accounts receivable	892	874
Inventories (Note 2)	721	553
Income taxes recoverable	4	20
Deposits and prepaid expenses	53	35
	1 680	1 482
Investments (Note 3)	509	356
Property, Plant and Equipment, net (Note 4)	6 197	6 223
Deferred Charges (Note 5)	67	78
	$ 8 453	$ 8 139

Approved on behalf of the Board

Director

Director

Liabilities and Shareholder's Equity	1987	1986
Current Liabilities		
Short-term notes payable	$ 313	$ —
Accounts payable and accrued liabilities	864	933
Current portion of long-term debt	6	13
Outstanding cheques less cash	—	88
	1 183	1 034
Long-term Debt (Note 6)	744	805
Deferred Credits (Note 7)	190	198
Deferred Income Taxes	1 633	1 469
Redeemable Preferred Shares (Note 8)	831	922
Capital (Note 9)	4 161	4 161
Deficit	(289)	(450)
	3 872	3 711
	$ 8 453	$ 8 139

Petro-Canada

Consolidated Statement of Earnings

For the year ended December 31, 1987
(stated in millions of dollars)

	1987	1986
Revenue		
Operating	$ 4 982	$ 5 089
Investment and other income	97	83
	5 079	5 172
Expenses		
Crude oil and product purchases	2 214	2 405
Marketing, general and administrative	819	787
Producing and refining	727	576
Depreciation, depletion and amortization	412	394
Taxes other than income taxes (Note 10)	394	512
Interest on long-term debt	59	36
Other interest	14	31
	4 639	4 741
Earnings before Undernoted Items	440	431
Provision for Income Taxes (Note 11)		
Deferred	164	165
Current	63	84
	227	249
Net Earnings before Dividends on Redeemable Preferred Shares	213	182
Dividends on Redeemable Preferred Shares (Note 8)	41	59
Net Earnings after Dividends on Redeemable Preferred Shares	$ 172	$ 123

Petro-Canada

Consolidated Statement of Retained Earnings

For the year ended December 31, 1987
(stated in millions of dollars)

	1987	1986
Retained Earnings (Deficit) at Beginning of Year	$ (450)	$ (519)
Net earnings before dividends on redeemable preferred shares	213	182
Dividends on redeemable preferred shares	(41)	(59)
Exchange adjustment on redemption of redeemable preferred shares	(11)	(54)
Retained Earnings (Deficit) at End of Year	$ (289)	$ (450)

Petro-Canada

Consolidated Statement of Changes in Financial Position

For the year ended December 31, 1987
(stated in millions of dollars)

	1987	1986
Internally Generated Cash		
Working capital provided from operations (Note 12)	$ 784	$ 728
Proceeds from sale of property, plant and equipment	46	59
Advances on future natural gas deliveries	(11)	(17)
Internally generated cash from operations	819	770
Decrease (increase) in operating working capital (Note 13)	(244)	406
	575	1 176
Investment Activities		
Expenditures on property, plant and equipment	488	614
Petroleum Incentive Program grants	(5)	(166)
Increase in investments, net	142	57
Increase in deferred charges, net	1	24
Acquisition of Gulf Canada Limited assets	—	301
	626	830
Financing Activities and Dividends		
Increase (decrease) in short-term notes payable, net	313	(532)
Redemption of redeemable preferred shares	(102)	(356)
Dividends on redeemable preferred shares	(41)	(59)
Reduction of long-term debt	(21)	(21)
Proceeds from issue of long-term debt	—	556
	149	(412)
Increase (Decrease) in Cash	98	(66)
Cash (Deficiency) at Beginning of Year	(88)	(22)
Cash and Short-Term Deposits (Deficiency) at End of Year	$ 10	$ (88)

Note 1: Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada, an agent of Her Majesty in right of Canada, and of all subsidiary companies ("the Corporation") except Canertech Inc., which is excluded for the reason described in Note 3.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition is attributed to the related assets acquired and is amortized over the life of these assets.

(b) Inventories

Inventories are stated at the lower of cost and net realizable value.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity method. Other long-term investments are accounted for on the cost method.

(d) Property, Plant and Equipment

The Corporation accounts for its investment in oil and gas properties on the full cost method whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, drilling both productive and non-productive wells and overhead related to exploration and development. Separate cost centres have been established for each country in which the Corporation has an interest in oil and gas properties. The Corporation applies a "ceiling test" to each of its producing oil and gas cost centres to ensure that such costs do not exceed the total of the estimated future net revenues from production of proven reserves, the unimpaired costs of certain projects in Canadian frontier areas and the unimpaired costs of unevaluated properties. The estimate of future net revenues is based upon prices and operating costs in effect at the balance sheet date. In addition a consolidated ceiling test provides for future administrative overhead, financing costs and income taxes.

Costs are accumulated separately for the Syncrude Project, producing in situ and other oil sands leases. Overburden removal costs relating to oil sands which will be mined in future years are deferred and are charged to earnings when the related oil sands are mined.

Substantially all of the Corporation's exploration and production activities are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

The interest cost of debt attributable to the construction of major new facilities is capitalized during the construction period.

(e) Depreciation, Depletion and Amortization

Costs incurred in producing oil and gas cost centres, other than unimpaired costs of certain projects in Canadian frontier areas and of unevaluated properties, and costs incurred on the Syncrude Project and producing in situ oil sands leases are depreciated or depleted separately on the unit of production method based on estimated proven recoverable oil and gas reserves before royalties. For purposes of calculating depreciation and depletion, natural gas production and reserves are converted to equivalent units of crude oil based on the relative energy content of each commodity.

Costs incurred in non-producing oil and gas cost centres and other oil sands leases are subject to review for impairment. Any impairment is charged to earnings. When exploration proves to be successful, and economic viability has been established, the unimpaired balance is depleted on the unit of production method when production commences.

Depreciation of other plant and equipment is provided on either the unit of production method or the straight line method as appropriate. Straight line depreciation rates are based on the estimated service lives of the related assets.

(f) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming depreciation, exploration, development and other costs for income tax purposes which differ from the related amounts charged to earnings.

Notes to Consolidated Financial Statements

December 31, 1987
(stated in millions of dollars)

Note 1: (Continued)

(g) Translation of Foreign Currency
Current assets, except inventories and prepaid expenses, current liabilities and long-term debt are translated at rates of exchange in effect at the balance sheet date. Long-term assets, inventories, prepaid expenses, deferred income taxes and redeemable preferred shares are translated at rates of exchange in effect at the respective transaction dates. Revenue and expense items are translated at the average rates of exchange in effect during the year, except for depreciation, depletion and amortization which reflect rates of exchange in effect when the assets were acquired.

The resulting exchange gains or losses are included in earnings, except for unrealized exchange gains or losses arising on translation of long-term debt, which are deferred and amortized over the remaining term of the debt.

Foreign operations are integrated with the Corporation's other activities and are translated in the manner described above.

Note 2: Inventories

	1987	1986
Crude oil, refined products and merchandise	$ 657	$ 498
Materials and supplies	64	55
	$ 721	$ 553

Note 3: Investments

	1987	1986
At equity		
Westcoast Transmission Company Limited	$ 219	$ 177
Petro-Canada Centre	188	84
Sedpex Inc.	38	31
Other	20	17
At cost		
Mortgages and other investments	44	47
	$ 509	$ 356

Westcoast Transmission Company Limited ("Westcoast")
At December 31, 1987 the Corporation held approximately 31% of the outstanding common shares of Westcoast with a quoted market value of $250 million (1986 – $165 million).

Petro-Canada Centre
At December 31, 1987 the Corporation held 50% of a joint venture which owns Petro-Canada Centre, an office complex in Calgary. The Corporation has entered into a long-term lease for use of a portion of the complex and has guaranteed $133 million of long-term debt related to the facility.

Sedpex Inc.
At December 31, 1987 the Corporation held 50% of the outstanding common shares of Sedpex Inc., a company which owns a semi-submersible drilling vessel. This vessel is under lease to the Corporation.

Canertech Inc. ("Canertech")
The accounts of Canertech, a wholly owned subsidiary company, have been excluded from consolidation because a formal plan exists to dispose of the investment in the subsidiary. In response to a directive by the Government of Canada, the Corporation incorporated Canertech in 1981 to develop alternate energy sources.
At that time the Government indicated its intention of purchasing the Corporation's investment at cost and establishing Canertech as an independent crown corporation. The Corporation is proceeding with the implementation of a Government directive to bring about the dissolution of Canertech. The Corporation's investment in Canertech is carried in the accounts at its original cost of one dollar.

Notes to Consolidated Financial Statements

December 31, 1987
(stated in millions of dollars)

Note 4: Property, Plant and Equipment

	1987			1986	Capital Expenditures	
	Cost	Accumulated Depreciation, Depletion and Amortization	Net	Net	1987	1986
Natural resources						
Oil and gas						
Canada	$ 5 234	$ 1 984	$ 3 250	$ 3 257	$ 239	$ 233
Foreign						
– producing	64	45	19	25	—	1
– non-producing	110	93	17	19	12	13
Oil sands						
Syncrude Project	709	132	577	554	44	48
Producing in situ	130	15	115	91	30	14
Other oil sands	207	207	—	—	5	6
Natural gas liquids	206	78	128	135	2	1
Other	111	82	29	29	4	—
	6 771	2 636	4 135	4 110	336	316
Refined oil products	2 369	448	1 921	1 975	122	112
Other property, plant and equipment	275	134	141	138	25	20
	$ 9 415	$ 3 218	$ 6 197	$ 6 223	$ 483	$ 448

At December 31, 1987, $3 074 million (1986 – $3 103 million) of Canada oil and gas net costs were subject to depreciation and depletion.

Note 5: Deferred Charges

	1987	1986
At cost		
Oil sands overburden removal costs	$ 40	$ 43
Less portion related to oil sands to be mined within one year	16	11
	24	32
Deferred pension funding	13	—
At amortized cost		
Deferred financing costs	14	16
Other	16	19
Translation adjustment on long-term debt	—	11
	$ 67	$ 78

(stated in millions of dollars)

Note 6: Long-Term Debt

	Maturity	1987	1986
In Canadian dollars			
8.25% unsecured notes	1993	$ 11	$ 14
Other		—	1
In United States dollars			
7.25% unsecured debentures (U.S.$200 million)	1996	260	276
8.25% unsecured debentures (U.S.$200 million)	2016	260	276
LIBOR less 0.8% unsecured notes (U.S.$125 million)	1995	162	173
9% unsecured notes (U.S.$30 million)	1995	39	52
7.75% unsecured notes (U.S.$14 million)	1993	18	19
8.45% unsecured notes		—	7
		750	818
Less current portion		6	13
		$ 744	$ 805

Repayment of long-term debt

The minimum repayment of long-term debt in each of the next five years is as follows:
1988 – $ 6 million 1989 – $ 6 million 1990 – $ 6 million 1991 – $ 7 million 1992 – $ 7 million

Note 7: Deferred Credits

	1987	1986
Advances on future natural gas deliveries	$ 118	$ 129
Long-term liabilities	39	69
Translation adjustment on long-term debt	33	—
	$ 190	$ 198

Note 8: Redeemable Preferred Shares

The redeemable preferred shares, which were issued by a subsidiary to a group of Canadian chartered banks, are floating rate, cumulative and non-voting. Cumulative dividends, payable quarterly, are, at the option of the subsidiary, based on a percentage of either the United States Base Rates or the London Inter-Bank Offered Rates of the banks. At December 31, 1987, the dividend rate was approximately 4.4% per annum. The shares are redeemable, at the option of the subsidiary, at one hundred dollars U.S. per share, plus accrued dividends. In 1987 the subsidiary exercised its option to redeem 779 000 shares (1986 – 850 000 shares) for a consideration of U.S.$78 million (1986 – U.S.$85 million). In 1986 the subsidiary repurchased an additional 1 728 000 shares for a consideration of U.S.$172 million. At December 31, 1987, 7 093 000 shares were outstanding.

Subsequent to December 31, 1987 the Corporation gave notice of its intention to redeem the shares by April 11, 1988. The funds for this redemption are to be provided by additional debt.

(stated in millions of dollars)

Note 9: Capital

Authorized

(a) 71 188 common shares with a par value of one hundred thousand dollars each, and

(b) Preferred shares issued to the Government of Canada provided that the amount of such shares together with any loans received, and outstanding, from the Consolidated Revenue Fund of the Government of Canada is not in excess of one billion dollars. These shares have a par value of one dollar each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

Issued (to the Government of Canada)

	Number of Shares	Consideration
Common Shares		
Balance at beginning and end of year	31 883	$ 3 188
Preferred Shares		
Balance at beginning and end of year	972 771 853	973
Total Capital at Beginning and End of Year		$ 4 161

Note 10: Taxes Other than Income Taxes

	1987	1986
Federal sales tax	$ 349	$ 411
Other	45	63
Petroleum and Gas Revenue Tax	—	38
	$ 394	$ 512

(stated in millions of dollars)

Note 11: Income Taxes

The provision for income taxes of $227 million (1986 – $249 million) represents an effective rate of 51.6% (1986 – 57.8%) on earnings before income taxes of $440 million (1986 – $431 million). The computation of the provision, which requires adjustment to earnings before income taxes for non-taxable and non-allowable items, is as follows:

	1987	1986
Earnings before income taxes	$ 440	$ 431
Add (deduct)		
Royalties and other payments to provincial governments	160	169
Federal allowances		
Resource allowance	(144)	(127)
Tax depletion	(36)	(39)
Petroleum and Gas Revenue Tax	—	38
Non-deductible depreciation, depletion and amortization	99	81
Non-taxable gains	(10)	(21)
Equity in earnings of affiliates	(25)	(18)
Other	(8)	(8)
Earnings as adjusted before income taxes	$ 476	$ 506
Canadian Federal income tax at 46.6% (1986 – 47.8%) applied to earnings as adjusted	$ 222	$ 242
Provincial and other income taxes, net of federal abatement	9	12
Provincial income tax rebates	(4)	(5)
Provision for income taxes	$ 227	$ 249

Note 12: Working Capital Provided from Operations

	1987	1986
Earnings before dividends on redeemable preferred shares	$ 213	$ 182
Add (deduct)		
Depreciation, depletion and amortization	412	394
Deferred income taxes	164	165
Equity earnings, net of dividends received	(4)	—
Other	(1)	(13)
	$ 784	$ 728

(stated in millions of dollars)

Note 13: Increase (Decrease) in Components of Operating Working Capital

	1987	1986
Accounts receivable	$ 18	$ (433)
Inventories	168	(557)
Income taxes recoverable	(16)	10
Deposits and prepaid expenses	18	2
Accounts payable and accrued liabilities	69	556
Other	(13)	16
	$ 244	$ (406)

Operating working capital is comprised of working capital other than cash and short-term deposits, short-term notes payable and current portion of long-term debt.

Note 14: Pension Plans

Effective January 1, 1987 the Corporation adopted prospectively the Canadian Institute of Chartered Accountants' new recommendations on accounting for pension costs and obligations. Prior to 1987 the Corporation charged to earnings an amount equal to that funded. The effect of this change was to increase 1987 net earnings by $6 million.

The Corporation's plans are defined benefit plans with the benefits generally based upon years of service and average salary during the final years of employment. They are funded by the Corporation based upon the advice of an independent actuary.

Plan Status as at December 31	1987	1986
Actuarial value of assets	$ 394	$ 351
Pension obligation	382	352
Net pension asset (obligation)	$ 12	$ (1)

The net pension asset (obligation) is amortized to earnings over the expected average remaining service life of the employees covered by the plans, which is currently 12 years.

1987 pension funding and expense amounted to $32 million and $17 million respectively.

Note 15: Related Party Transactions

Transactions with the Government of Canada and its agencies are in the normal course of business and are therefore on the same terms as those accorded to non-related parties.

(stated in millions of dollars)

Note 16: Segmented Information

The Corporation operates in two business segments:

Natural resources, comprising: exploration, development, production, transportation and marketing activities for crude oil, natural gas, field liquids, sulphur and oil sands; and extraction of liquids from natural gas.

Refined oil products, comprising: purchase and sale of crude oil; refining crude oil into oil products; and distribution and marketing of these and other purchased products.

Financial information by business segment is presented in the following table as though each segment were a separate business entity. Inter-segment transfers of products, which are accounted for at market value, are eliminated on consolidation. Corporate and other includes investment income, interest expense and unallocated general corporate revenues and expenditures. Corporate and other assets are principally cash and short-term deposits, investments in other companies and general corporate assets.

	Natural Resources		Refined Oil Products		Corporate and Other		Consolidated	
	1987	1986	1987	1986	1987	1986	1987	1986
Revenue								
Sales to customers and other revenues	$ 571	$ 546	$ 4 461	$ 4 588	$ 47	$ 38	$ 5 079	$ 5 172
Inter-segment sales	567	534	—	—	—	—		
Segment Revenue	$ 1 138	$ 1 080	$ 4 461	$ 4 588	$ 47	$ 38		
Earnings								
Operating earnings before depreciation, depletion and amortization	$ 623	$ 470	$ 327	$ 365	$ (25)	$ 57	$ 925	$ 892
Depreciation, depletion and amortization	(266)	(245)	(139)	(141)	(7)	(8)	(412)	(394)
Interest	—	—	—	—	(73)	(67)	(73)	(67)
Provision for income taxes	(195)	(168)	(93)	(109)	61	28	(227)	(249)
Net Earnings (Loss) Before Dividends on Redeemable Preferred Shares	$ 162	$ 57	$ 95	$ 115	$ (44)	$ 10	$ 213	$ 182
Capital Expenditures								
Capital expenditures on property, plant and equipment, deferred charges and investments	$ 328	$ 319	$ 118	$ 118	$ 180	$ 92	$ 626	$ 529
Acquisitions including minority interests	—	—	—	301	—	—	—	301
	328	$ 319	$ 118	$ 419	$ 180	$ 92	$ 626	$ 830
Total Assets	$ 4 431	$ 4 392	$ 3 436	$ 3 222	$ 586	$ 525	$ 8 453	$ 8 139
Capital Employed	$ 4 207	$ 4 102	$ 2 815	$ 2 698	$ 567	$ 318	$ 7 589	$ 7 118

Note 17: Comparative Figures

Certain reclassifications have been made to the 1986 comparative figures to conform with the current year's presentation.

Note 18: Commitments and Contingencies

(a) Commitments

The Corporation has leased property and equipment under various long-term operating leases for periods up to 2008. The minimum annual rentals for non-cancellable operating leases are estimated at $73 million in 1988, $49 million in 1989, $49 million in 1990, $40 million in 1991, $36 million in 1992 and $17 million per year thereafter until 2008.

(b) Contingencies

The Corporation is involved in litigation and claims associated with normal operations. Management is of the opinion that any resulting settlements would not materially affect the financial position of the Corporation.

Glossary of Financial Terms

Capital employed	Total assets less current liabilities excluding short-term notes payable and the current portion of long-term debt. Average capital employed is the average of the current year's and previous year's capital employed balances measured at year end.
Cash flow return on average capital employed	Working capital provided from operations as disclosed in the financial statements plus tax adjusted interest expense plus investment tax credits divided by average capital employed.
Cash flow to debt plus redeemable preferred shares	Cash generated from operations divided by long-term debt including the current portion of long-term debt, short-term notes payable, outstanding cheques less cash, advances on future natural gas deliveries and redeemable preferred shares valued at year-end U.S. $/Cdn. $ exchange rates.
Cash generated from operations	Internally generated cash from operations as disclosed in the financial statements less dividends on redeemable preferred shares.
Debt plus redeemable preferred shares to capital	Long-term debt including the current portion of long-term debt, short-term notes payable, outstanding cheques less cash, advances on future natural gas deliveries and redeemable preferred shares divided by shareholder's equity plus total debt obligations (as defined above) and redeemable preferred shares. Redeemable preferred shares are valued at year-end U.S. $/Cdn. $ exchange rates; retained earnings also reflect this valuation.
Gross capital expenditures	Total expenditures on property, plant and equipment.
Net capital expenditures	Expenditures on property, plant and equipment less Petroleum Incentive Program grants.
Reinvestment ratio	Net capital expenditures divided by cash generated from operations.
Return on average capital employed	Earnings before unusual items and dividends on redeemable preferred shares plus tax adjusted interest expense divided by average capital employed.
Return on average shareholder's equity	Earnings before unusual items and after dividends on redeemable preferred shares divided by average shareholder's equity. Average shareholder's equity reflects the valuation of redeemable preferred shares at year-end U.S.$/ Cdn. $ exchange rates.

Reserves Information

(proven reserves, net after royalties)

	1987			1986		
	Developed	Undeveloped	Total	Developed	Undeveloped	Total
Crude oil and natural gas liquids (thousands of m³)						
Conventional crude oil	27 373	2 097	29 470	27 863	2 245	30 108
Synthetic crude oil	29 865	3 906	33 771	29 401	3 906	33 307
Bitumen	1 265	3 399	4 664	1 227	3 399	4 626
Natural gas liquids	4 447	977	5 424	4 371	892	5 263
Total	62 950	10 379	73 329	62 862	10 442	73 304
Natural gas (millions of m³)	57 873	20 350	78 223	57 813	19 510	77 323

	1987			1986		
	Oil (thousands of m³)	NGL (thousands of m³)	Gas (millions of m³)	Oil (thousands of m³)	NGL (thousands of m³)	Gas (millions of m³)
Balance, beginning of year	68 041	5 263	77 323	66 862	5 494	77 862
Revisions of previous estimates	3 678	741	4 142	5 350	326	1 950
Extension and discoveries	637	—	386	199	—	486
Production	(4 451)	(580)	(3 628)	(4 370)	(557)	(2 975)
Balance, end of year	67 905	5 424	78 223	68 041	5 263	77 323

Notes:

1. Reserves quantities in the Annual Report, excluding synthetic crude oil, are reported based on estimates consistent with the knowledge of the characteristics and extent of underlying productive formations at each year end.
2. The above figures include Petro-Canada's 17% interest in the synthetic crude oil reserves of Syncrude. These reserves are based on the demonstrated production capacity of the Syncrude plant and an estimate of the incremental production attributable to the capital program scheduled for completion in 1988, both calculated over the remaining term of the current operating permit to the year 2013.
The Syncrude project is subject to a royalty agreement between the Province of Alberta and the Syncrude participants whereby the Province has the right to 50% of Syncrude's deemed net profit. The Province has an option to convert its royalty to a 7.5% gross overriding royalty.
The net after royalty reserves of Syncrude are based on an estimated average royalty rate for the life of the project using current prices and operating costs.

Petro-Canada

Five Year Financial Summary

(stated in millions of dollars)

	1987	1986	1985	1984	1983
Summary of Earnings					
Revenue	$ 5 079	$ 5 172	$ 5 381	$ 4 988	$ 4 171
Expenses	4 639	4 741	4 868	4 376	3 797
	440	431	513	612	374
Add (deduct)					
Provision for income taxes	(227)	(249)	(341)	(385)	(268)
Minority interest	—	—	2	5	6
Earnings before unusual and extraordinary items and dividends on redeemable preferred shares	213	182	174	232	112
Unusual items	—	—	865	—	—
Extraordinary items	—	—	—	—	17
Net earnings (loss) before dividends on redeemable preferred shares	213	182	(691)	232	95
Dividends on redeemable preferred shares	41	59	78	100	86
Net earnings (loss) after dividends on redeemable preferred shares	$ 172	$ 123	$ (769)	$ 132	$ 9
Other Financial Data					
Cash generated from operations	$ 778	$ 711	$ 828	$ 868	$ 622
Expenditures on property, plant and equipment	488	614	1 059	1 131	997
Petroleum Incentive Program grants	5	166	349	380	469
Acquisitions including minority interests	—	301	1 010	(2)	530
Total assets	8 453	8 139	8 846	8 966	8 194
Average capital employed	7 353	7 226	7 746	7 780	7 132
Working capital	497	448	397	905	809
Long-term debt (Note 3)	750	818	289	157	188
Redeemable preferred shares	831	922	1 224	1 312	1 394
Shareholder's equity	3 872	3 711	3 642	4 478	3 932
Annual Operating Revenues					
Resources Division					
Crude oil and natural gas liquids					
Conventional crude oil	$ 413	$ 336	$ 613	$ 585	$ 523
Synthetic crude oil	192	167	279	214	225
Bitumen	19	13	14	—	—
Field natural gas liquids	57	50	80	67	59
	681	566	986	866	807
Natural gas	203	219	292	284	238
Sulphur	25	31	34	27	19
Natural gas liquids from straddle plants	145	192	235	246	239
Other	84	72	89	116	88
Total	$ 1 138	$ 1 080	$ 1 636	$ 1 539	$ 1 391

	1987	1986	1985	1984	1983
Annual Operating Revenues (Continued)					
Products Division					
Gasolines	$ 2 240	$ 2 280	$ 2 232	$ 1 814	$ 1 545
Distillates	1 384	1 549	1 350	1 025	873
Other including petrochemicals	837	759	768	592	531
Total	$ 4 461	$ 4 588	$ 4 350	$ 3 431	$ 2 949
Expenditures on Property, Plant and Equipment					
Resources Division					
Exploration					
Frontier	$ 41	$ 245	$ 442	$ 601	$ 581
Western provinces	101	62	145	128	123
Foreign	12	11	19	30	6
Development					
Western provinces	108	99	166	104	127
Foreign	—	1	6	6	—
Oil Sands					
Syncrude	44	47	60	31	22
Other	35	17	30	53	5
	341	482	868	953	864
Products Division					
Refining	49	55	115	90	49
Marketing	73	57	50	33	49
	122	112	165	123	98
Support facilities	25	20	26	55	35
	488	614	1 059	1 131	997
Petroleum Incentive Program grants	5	166	349	380	469
Total	$ 483	$ 448	$ 710	$ 751	$ 528
Reinvestment ratio	0.62	0.63	0.86	0.87	0.85
Financial Indicators (per cent)					
Performance					
Return on average capital employed	3.4	3.0	2.4	3.1	1.8
Cash flow return on average capital employed	11.3	10.7	11.7	11.9	9.5
Return on average shareholder's equity	4.7	3.5	2.5	3.2	0.7
Leverage					
Debt plus redeemable preferred shares to capital	35.7	37.4	41.8	29.6	32.2
Cash flow to debt plus redeemable preferred shares	37.0	33.5	33.8	48.0	34.1

Notes:

1. Financial and operating results are included from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, and from October 1, 1985, for the operations of the assets aquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986 for the operations of the former Gulf Canada Limited Edmonton refinery.
2. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
3. Long-term debt includes current maturities.

Five Year Operating Summary

	1987	1986	1985	1984	1983
Oil and Gas Landholdings (gross/net)					
(millions of hectares)					
Canadian provinces					
Alberta – Oil and natural gas rights	2.2/1.1	2.3/1.1	2.6/1.2	3.0/1.4	3.1/1.6
– Oil sands rights	1.0/0.4	1.1/0.4	1.0/0.4	0.9/0.3	0.9/0.3
British Columbia	0.9/0.5	1.1/0.6	1.4/0.7	1.3/0.7	1.3/0.7
Saskatchewan	0.2/0.1	0.2/0.2	0.2/0.1	0.2/0.1	0.3/0.1
Other provinces	0.1/0.1	0.1/0.1	0.2/0.1	0.3/0.2	1.3/0.7
	4.4/2.2	4.8/2.4	5.4/2.5	5.7/2.7	6.9/3.4
Frontier Canada	8.0/5.4	14.2/8.0	33.2/16.5	41.6/20.5	54.4/25.0
International	1.3/0.7	1.2/0.5	3.4/1.1	2.8/0.4	1.7/0.1
Total	13.7/8.3	20.2/10.9	42.0/20.1	50.1/23.6	63.0/28.5
Wells Drilled (gross/net)					
Non-frontier areas – exploratory wells					
Oil	20/11	21/13	42/30	65/45	41/30
Gas	10/6	34/15	50/27	25/11	24/16
Dry	35/25	42/24	75/53	74/47	68/48
	65/42	97/52	167/110	164/103	133/94
Non-frontier areas – development wells					
Oil	199/74	283/51	482/169	344/134	148/84
Gas	45/27	32/10	47/26	16/6	17/12
Oil sands	75/38	4/2	—/—	193/96	27/13
Dry	20/13	14/7	48/21	24/10	9/5
	339/152	333/70	577/216	577/246	201/114
Frontier and international – exploratory and development wells					
Oil	3/1	9/2	16/4	9/2	5/1
Gas	—/—	9/3	10/4	9/2	6/2
Dry	6/2	19/6	26/7	25/8	14/5
	9/3	37/11	52/15	43/12	25/8
Total	413/197	467/133	796/341	784/361	359/216
Proven Reserves					
(net, before royalties/after royalties)					
Natural gas (billions of m^3)	96.9/78.2	96.7/77.3	98.8/77.9	120.4/100.4	134.3/108.8
Sulphur (millions of tonnes)	5.4/4.6	5.2/4.4	5.5/4.6	4.8/4.0	5.6/4.7
Crude oil and natural gas liquids (millions of m^3)					
Conventional crude oil	37.2/29.5	38.9/30.1	41.3/30.4	48.1/34.3	45.9/33.3
Synthetic crude oil	39.7/33.8	39.2/33.3	39.1/33.2	25.4/21.6	26.3/22.3
Bitumen	4.9/4.6	4.9/4.6	4.5/4.3	1.1/1.0	—/—
Natural gas liquids	7.2/5.4	7.1/5.3	7.5/5.5	6.4/4.7	7.4/5.1
Total	89.0/73.3	90.1/73.3	92.4/73.4	81.0/61.6	79.6/60.7

	1987	1986	1985	1984	1983
Daily Production					
(net, before royalties/after royalties)					
Natural gas (millions of m³)	12.3/9.9	10.2/8.2	11.6/9.1	10.8/9.0	10.0/8.1
Sulphur (thousands of tonnes)	1.0/0.8	0.9/0.8	0.9/0.8	1.4/1.2	1.1/0.9
Crude oil and natural gas liquids (thousands of m³)					
Conventional crude oil	10.1/8.1	10.1/8.0	10.1/7.7	10.7/7.8	9.8/7.2
Synthetic crude oil	3.7/3.6	3.5/3.4	3.5/3.1	2.3/2.1	3.0/2.4
Bitumen	0.5/0.5	0.6/0.6	0.2/0.2	—/—	—/—
Field natural gas liquids	2.1/1.6	2.1/1.5	1.8/1.3	1.5/1.1	1.5/1.0
Total	16.4/13.8	16.3/13.5	15.6/12.3	14.5/11.0	14.3/10.6
Natural gas liquids production from straddle plants including ethane (thousands of m³)	6.3	6.5	5.7	6.3	6.1
Average sale prices					
Crude oil and field natural gas liquids ($ per m³)	140	115	227	213	204
Natural gas ($ per thousand m³)	57	75	87	88	85
Marketing					
Retail and wholesale marketing outlets	4 268	4 344	4 620	2 716	3 107
Petroleum product sales (thousands of m³ per day)					
Gasolines	20.3	20.3	16.3	13.9	12.9
Distillates	16.7	16.2	12.2	9.6	8.7
Other including petrochemicals	8.6	7.9	7.0	6.3	5.5
Total	45.6	44.4	35.5	29.8	27.1
Refining					
Refinery crude capacity (thousands of m³ per day)	64.0	64.0	46.2	31.6	31.6
Crude oil processed by Petro-Canada (thousands of m³ per day)	48.4	47.2	34.2	27.6	25.3
Refinery utilization (per cent)	76	74	78	86	78
Employees					
Number at year end	7 204	7 740	9 747	6 798	6 272

Notes:
1. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentations.
2. Operating results are included from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the former Gulf Canada Limited Edmonton refinery.

Executive Council members, left to right: Jim Stanford, David O'Brien, Bob Mayo (standing), Ed Lakusta and Bill Hopper

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Litho Canada

1988 ANNUAL REPORT

PETRO-CANADA

CONTENTS

Cover:
John Blomfield manages Petro-Canada's task force on development of the Terra Nova offshore oilfield.

CORPORATE PROFILE

Petro-Canada is Canada's national energy corporation. Formed by an Act of Parliament in 1975, it is wholly owned by the Government of Canada. Operations began on January 1, 1976. Petro-Canada operates in a commercial fashion, competing in today's oil and gas industry on the same basis as other integrated energy companies. It is the largest Canadian-owned oil and gas company, with assets of over $8.5 billion and revenue in 1988 of almost $5 billion.

Petro-Canada has 7 373 employees organized into two operating divisions along with supporting "corporate" groups. Petro-Canada Resources, the "upstream" business, explores for, produces and markets crude oil, natural gas and natural gas liquids. The "downstream" business, Petro-Canada Products, refines, distributes and markets petroleum products and offers customers related goods and services.

On a typical day, Petro-Canada produces approximately 16 700 cubic metres of crude oil and field natural gas liquids and 13.7 million cubic metres of natural gas. The Corporation's straddle plants extract from pipeline natural gas an additional 6 400 cubic metres of natural gas liquids including ethane. Petro-Canada accounts for over 5.5 per cent of domestic oil and field natural gas liquids production and close to 6 per cent of domestic natural gas production. The Corporation operates more than 70 oil and gas production facilities in Western Canada.

At year-end 1988, Petro-Canada had proven reserves of crude oil and field natural gas liquids of 92.5 million cubic metres before royalties. These reserves include Petro-Canada's interests in the Syncrude and Wolf Lake oil sands projects. Proven reserves of natural gas amounted to 97.9 billion cubic metres before royalties.

Petro-Canada also has significant potential reserves off Canada's East Coast and in the oil sands areas of Alberta.

Petro-Canada holds interests in 12 crude oil, natural gas liquids and refined products pipelines. It is operator of nine pipelines with a total throughput capacity of 78 000 cubic metres per day.

The Corporation sells about 43 million litres of refined products to 600 000 Canadians each day. The Petro-Canada brand is the top-selling gasoline in the country, with over 19 per cent of the market. The Corporation offers a full range of high-quality, HydroTreated lubricants. A nationwide retail network comprises 3 429 outlets. Industrial and commercial customers are served through 34 terminals, 401 bulk plants and 118 Petro-Pass truck fuelling facilities.

Petro-Canada operates five refineries in Quebec, Ontario, Alberta and British Columbia, a lubricants plant in Ontario and an asphalt plant in Saskatchewan. With about 22 per cent of total Canadian refining capacity, these facilities can process 60 600 cubic metres of crude oil per day into a full range of high-quality petroleum products.

March 23, 1989

The Honourable
Jake Epp, P.C., M.P.
Minister
Energy, Mines and
Resources Canada
House of Commons
Ottawa, Ontario

Dear Minister:

On behalf of the Board of Directors, I am pleased to present Petro-Canada's Annual Report for the fiscal year ended December 31, 1988.

In accordance with the provisions of the Financial Administration Act, the Report includes the consolidated financial statements together with the auditors' report thereon.

Yours sincerely,

W. H. Hopper
Chairman of the Board
and Chief Executive Officer

HIGHLIGHTS

Financial	1988	1987
Earnings after extraordinary item and dividends on redeemable preferred shares (millions of dollars)	94	172
Cash generated from operations (millions of dollars)	613	778
Capital expenditures on property, plant and equipment (millions of dollars)	799	483
Cash flow return on average capital employed (per cent)	9.2	11.3
Return on average capital employed (per cent)	2.6	3.4
Return on average shareholder's equity (per cent)	3.0	4.7
Total assets (millions of dollars)	8 611	8 453
Shareholder's equity (millions of dollars)	3 915	3 872

Operating	1988	1987
Crude oil and field natural gas liquids daily production, net before royalties		
(thousands of cubic metres)	16.7	16.4
(thousands of barrels)	105	103
Natural gas daily production, net before royalties		
(millions of cubic metres)	13.7	12.3
(millions of cubic feet)	485	435
Crude oil processed per day		
(thousands of cubic metres)	48.5	48.4
(thousands of barrels)	305	304
Petroleum product sales per day		
(thousands of cubic metres)	43.8	45.6
(thousands of barrels)	276	287

THE YEAR IN BRIEF

- Consolidated earnings and cash flow down
- Exchange rates and low resource prices cut upstream results
- Downstream returns improve slightly
- Agreement-in-principle signed to develop Hibernia

During 1988, operations were directionally sound and well executed, but financial results were less than satisfactory. In the upstream, production of oil and natural gas liquids was maintained at last year's high level through investments in field development. Natural gas production and sales reached record levels, and it was a good exploration year in both oil and gas. Important agreements were signed that bode well for the Hibernia offshore oil development and the proposed OSLO oil sands project. In the downstream, initiatives in refining resulted in more effective operations.

In spite of all this, Petro-Canada's financial results were poorer than anticipated. This was largely due to the deterioration in crude oil prices in the second half of the year, the strength of the Canadian dollar and natural gas prices that fell to their lowest level in nine years. Even with the stability afforded by the Corporation's status as an integrated company, weak commodity prices hurt earnings and cash flow. Net earnings in 1988 were $94 million after an extraordinary write-down of $22 million, down 45 per cent from the previous year. Cash generated from operations totalled $613 million, off 21 per cent from 1987.

Our organization continued to pursue a series of strategies adopted after the oil price collapse in 1986. These directions are extensively discussed in this year's report, including the adjustments made in 1988 to reflect evolving conditions in the industry. To pursue attractive business opportunities in natural gas, commitments in exploration, development and marketing were strengthened and interests in several natural gas fields were purchased in the first half of the year. As a result, capital spending increased 65 per cent to $799 million. The subsequent weakening in world oil prices meant that capital expenditures for the year exceeded cash flow; however, this investment activity places Petro-Canada in a strong position to improve earnings in the medium term.

The latter part of 1988 was yet another reminder that our business environment is one of ongoing uncertainty. With the fundamentals of the oil and gas industry inextricably tied to a complex web of political, economic and social factors, our economists feel no comfort in their price forecasts. Toward the end of 1988, we revised downward our outlook for crude oil prices, and budgets for 1989 have been based on a price well below the average level for the previous year. We expect prices will strengthen significantly in the 1990s although the timing of such changes is far from clear.

In the light of this uncertainty, future investments must be continually re-evaluated. This is particularly true for the large, long-term upstream projects that develop relatively high-cost supplies. Natural gas prospects in North America appear to be good over the next few years with the dissipation of the continental supply surplus, although revenues will be held back by the slow rise in prices for competing fuels. Exploration for oil internationally offers the opportunity to participate in large, low-cost discoveries that Canadian-owned companies such as Petro-Canada can use to supplement domestic production and enhance growth.

After several years of poor profitability, the refining and marketing business also gives us cause for optimism. Gradually increasing product demand and product quality requirements will raise capacity utilization in refining. When combined with more focused marketing approaches, these trends should lead to higher profitability in the medium term. If realized,

these gains will allow Petro-Canada, as an integrated company, to offset any further weakness in upstream earnings with greater downstream profits.

The Corporation will remain particularly careful in managing its debt while oil prices remain weak. Should our shareholder opt for privatization, access to additional equity will ease the situation. In any event, prudent investment practices and effective cost controls will continue to be followed.

Over the year we watched closely some societal issues indirectly related to oil markets. For instance, there has been a tremendous growth in public concern about the physical environment. The Corporation has responded by strengthening its environmental policy and initiating programs such as the "Maximum" line of unleaded gasolines. The year was also notable for the nation's decision in favour of the U.S./Canada Free Trade Agreement. Petro-Canada will take full advantage of opportunities afforded by the Agreement, especially in natural gas marketing.

The constraints posed by weak crude prices have provided additional pressure to look within our organization and find ways to do things better. The Corporation has to ensure its employees are as motivated and as effective as possible. From the findings of a comprehensive employee survey, we put in motion programs that are improving management approaches and streamlining operating practices. The same principles have led our downstream division to begin adjusting every part of its organization to focus on customers. This multi-year initiative will mean additional attention on the thousands of people across Canada who work in retail and wholesale outlets under the Petro-Canada banner. The objective is to strengthen sales by gaining and keeping more satisfied customers.

We recognize once again that it is our employees who provide the true value for our Corporation, and we salute their efforts under conditions that remain stressful and challenging because of the uncertain business environment. Regrettably, Petro-Canada lost two members of its senior management in early 1989. I would like to thank both David O'Brien and Bob Mayo for their invaluable contribution over many years.

There were changes to our Board of Directors during 1988, including the resignation in March of Rudolph Bratty and in May of Robin Abercrombie. I want to express my appreciation to both for their service on Petro-Canada's Board.

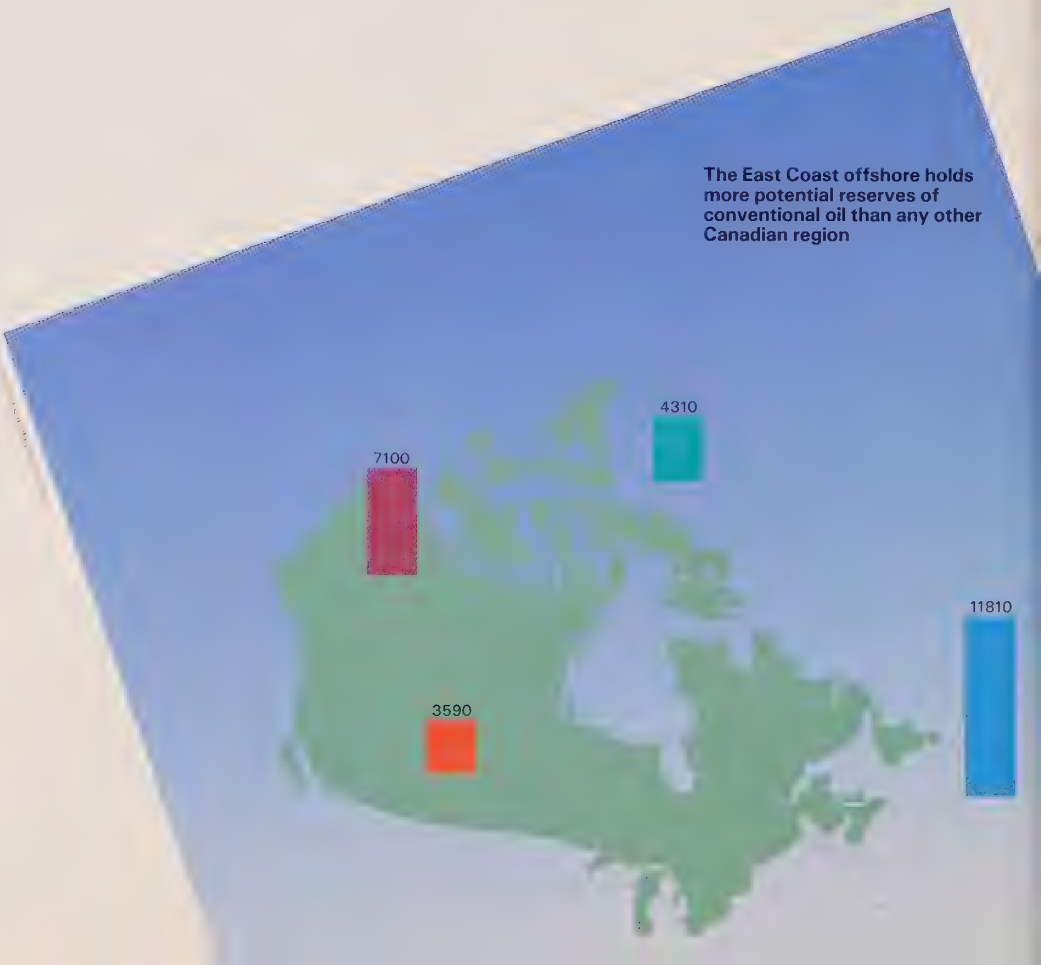
We continue to be gratified by the enduring success of the Olympic Torch Relay, which Petro-Canada sponsored and organized for the XV Olympic Winter Games. The event raised Petro-Canada's profile and confirmed for many the Corporation's ability to take on a major challenge and carry it through with distinction.

W. H. Hopper
Chairman of the Board
and Chief Executive Officer
March 23, 1989

East Coast Offshore Oil Development

Petro-Canada is among those industry leaders who see the East Coast offshore as the next major petroleum supply region for Canada. In 1988, an industry consortium that includes Petro-Canada signed a Statement of Principles with the federal and Newfoundland governments that should lead to construction of the massive Hibernia development, beginning shortly after the Binding Agreement is signed. The project aims to bring oil ashore from the Grand Banks by the mid-1990s. With its partners, Petro-Canada also expects to produce the nearby Terra Nova discovery by about the same time.

Low oil prices over the last three years have added uncertainty to the timing of East Coast offshore projects. However, the Hibernia agreement shares the risks between governments and project sponsors, recognizing that the project may proceed under pricing expectations that leave much to be desired.



Ultimate technically recoverable resources, average expectation (millions of barrels)

- Eastern Canada Offshore
- Arctic Islands
- Beaufort Sea Mackenzie Delta
- Western Canada Sedimentary Basin

Conventional oil becoming harder to find

Canada is currently a net exporter of oil. Yet that comforting fact obscures some disconcerting truths. The nation is a net importer of the light oil required by its refineries, while much of the crude exported is lower-value bitumen and heavy oil.

Production of conventional light crude oil from Western Canada can no longer meet national demand. Current daily production of 1.1 million barrels accounts for only 70% of total refinery feedstock requirements. And while these requirements are forecast by Ottawa's National Energy Board (NEB) to remain relatively flat for the next decade, conventional production is expected to decline rapidly.

There is still more conventional light oil to be found in Western Canada – some 3.6 billion barrels according to the Geological Survey of Canada. Most of it, however, lies in small, scattered pools that will become increasingly costly to find and develop. The Canadian Energy Research Institute calculates that crude oil finding costs in Alberta rose from $5.53 per barrel in 1984 to $7.28 in 1985 and $9.23 in 1986 (three-year moving averages in 1986 dollars). This trend is expected to continue.

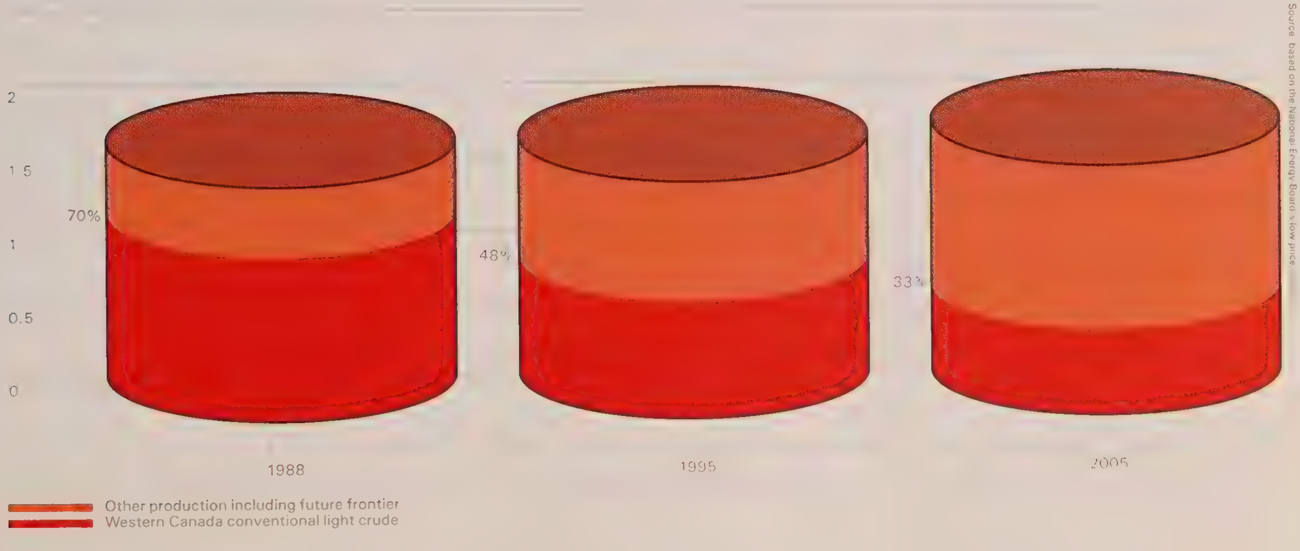
But Canada does have alternative sources of oil. The supply options include bitumen and synthetic crude from oil sands in northern Alberta, heavy oil in Saskatchewan and eastern Alberta, and oil fields discovered in the frontiers, such as in the Beaufort Sea and off the East Coast.

Reserves from all of these areas may eventually be commercially produced to meet future needs. However, the size of the discoveries, the advanced stage of preparation toward development, and the economic feasibility within current price forecasts all point to the East Coast as the most likely first choice for development. Indeed, by the mid-1990s, the Grand Banks could provide 10 to 15% of Canada's light oil production. Hibernia's recoverable reserves have been estimated at approximately 525 million barrels. Encouraging results from Terra Nova delineation wells indicate the field could have probable reserves significantly higher than the current estimate of 132 million barrels.

A similar-sized field may exist at the nearby Whiterose East location, and the Ben Nevis, West Ben Nevis and Hebron discoveries also show development potential. To put these numbers into perspective, the largest Western Canada discovery announced in 1988, the Brassey field in northeastern B.C., was rated at about 20 million barrels of recoverable reserves.

Oil discoveries have been made off Nova Scotia, but the Cohasset and Panuke finds appear to be too small to produce profitably under the current price outlook.

Canadian refinery requirements will have to be met from additional sources as production of Western Canada conventional light oil declines
(millions of barrels per day)



Assuming the financial risk

While the case for offshore oil is a good one, the steps needed to move from the drawing board to production are formidable. Project sponsors face decisions that carry tremendous consequences. Misjudgment could result in a crippling financial burden even for large companies, yet some of the criteria for decision making are virtually unpredictable.

The risks of megaproject development hinge on their immense scale, heavy front-end investments, long lead-times before production and technical uncertainties. Hibernia, for instance, will cost about $5.2 billion to production start-up. Production and first revenues will not commence until six years after construction has started and more than a decade and a half after the discovery well. Time spans of this order present enormous risks because critical factors, most notably the price of oil, can change and alter the expected rate of return.

Petro-Canada estimates the average operating and capital cost of Hibernia production, over the life of the project, to be U.S. $16 to 18 per barrel (1988 dollars). The NEB's low-end price forecast, adjusted to 1988 dollars, envisions approximately $16 per barrel for West Texas Intermediate over the next two to three years, about $17 per barrel by 1995, when Hibernia is to begin production, and about $19 by the end of the century. If actual prices match the NEB's low-end forecast, capital and operating costs for Hibernia would be covered. However, the complexities of OPEC politics make the world oil price too difficult to predict with much comfort. It must be recognized that a sustained downward trend could affect project timing or limit eventual profitability.

At this stage of megaproject development in Canada, and under current oil price expectations, government participation is essential for these projects to proceed. Governments help shoulder the risk in exchange for a share in the benefits. For Hibernia, the federal and Newfoundland governments have agreed to a complex package of fiscal incentives.

Risk sharing is critical

Even when the economics are favourable, the scale of megaprojects puts them beyond the scope of a single company or even an industry consortium acting alone. The heavy front-end investments, the time consumed in design, approvals and construction, the financial risks, the industrial opportunities and jobs that can be provided, and the environmental impacts that need to be addressed all require governments and industry to work closely together. For the petroleum industry, today's volatile world oil markets add a further dimension, leading governments and industry to risk-sharing agreements that protect their various interests.

Before a project can proceed, participating companies must seek to minimize risk by limiting their capital exposure. They must also recover their costs and receive an acceptable rate of return on invested capital.

Governments want oil production for energy security, an improved balance of payments, job creation, regional economic growth, royalty and tax revenues, and indirect social benefits. Through various incentives, they attempt to reduce the financial risks facing the companies. Of course, governments are keenly aware of the multiplier effect of project spending and are eager to capture as much of that spending as possible within their borders. In return for project financial assistance, companies are often willing to make specific commitments to levels of local or national content.

Hibernia development scheduled to proceed

The Hibernia field was discovered in late 1979, and nine subsequent wells have delineated the field. The project owners submitted a development plan to governments during 1985, to which approval was given in 1986.

Recovering oil from Hibernia will require a massive platform, known as a gravity base structure (GBS), that rests on the seabed. To protect it from pack ice and icebergs, the GBS has been developed with a 100-metre wide, 85-metre tall outer caisson wall. The GBS will provide stability for a huge operations base from which wells can be drilled and produced, much as if they were on land. In addition, it offers storage for about 1.5 million barrels of oil, roughly 10 days of production. Most of the 83 wells will be drilled directionally from the platform, with some 35 outlying wells being drilled from semi-submersible rigs. The produced oil will be processed on the GBS and pumped to two loading platforms where shuttle tankers can safely tie up and receive cargo bound for onshore refineries.

The scale of the proposed Hibernia production platform would dwarf the Calgary Tower.

The Hibernia Statement of Principles

The Statement of Principles for the Hibernia project is a textbook example of the balance that must be struck between private and public interests before the launching of an energy megaproject. The essence of this fiscal agreement is that, in return for reducing the consortium's financial risk, the federal and Newfoundland governments will be entitled to an escalating share of the returns once the project pays for itself.

The federal government will provide up to $1.04 billion in grants to cover 25% of eligible capital costs. Ottawa will also guarantee up to $1.66 billion in financing (to be provided by the private sector) which can be drawn down at the rate of 40% of capital costs. The federal and Newfoundland governments will contribute additional amounts, totalling $106 million, from funds already earmarked for offshore development. If oil prices remain low after project start-up, the federal government will help out with interest assistance and additional guarantees for temporary financing. The province has agreed to exempt capital spending from its retail sales tax and reduce sales tax payable on operating costs.

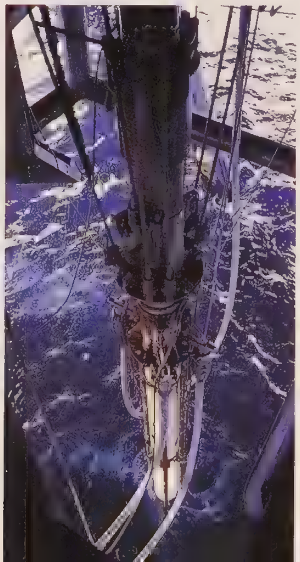
The federal government has the option to acquire a 10% net profit interest in the project after repayment of the guaranteed financing and interest assistance. The agreement specifies that royalties payable to Newfoundland will be graduated; they will start low and be indexed to crude oil prices and rise once the consortium has earned a predetermined return. If the project turns out to be very profitable, royalties could be as high as 42.5% of net revenues. Also, the project sponsors will attempt to source in Canada, on a competitive basis, between 45 and 50% of project development expenditures to production start-up. They will endeavour to contract a significant portion of the outfitted concrete base in Newfoundland.

The Hibernia deal should allow a project to proceed that will increase Canada's production capability, develop new technologies and meet the consortium's expectations of an adequate rate of return. Governments stand to gain significant revenues over the life of the project while the nation gains important economic benefits and greater energy security.

Moving forward at Terra Nova

Terra Nova, among the largest East Coast oil fields discovered to date, is proceeding toward development. Petro-Canada, the operator and largest interest holder, completed drilling the Terra Nova K-08 discovery in 1984. It followed up with seven additional wells to delineate the field and assess its reservoir characteristics. Fiscal negotiations on the proposed development have yet to commence.

Unlike Hibernia, Terra Nova's smaller reserves are insufficient to support the cost of a GBS, and a floating production system is planned that can disconnect and move if threatened by ice. Preliminary engineering is under way to select the most appropriate surface vessel for the production system. Wells will be drilled from conventional offshore rigs. Oil from the subsea wells will move through flow lines to the surface vessel where, after processing and storage, it will be off-loaded to tankers for delivery to shore. The floating concept being developed for Terra Nova may have wide application for other Grand Banks fields.



Further prospects for the East Coast

Both Hibernia and Terra Nova could be catalysts for further offshore energy developments. They will attract specialized skills from around the world and promote the transfer of technology to Canada. Infrastructure for the construction, maintenance and supply of offshore megaprojects will be developed and will help to reduce costs for the next generation of projects. This could bring smaller reserves within economic reach, and create a more consistent level of activity. There will be cash flow to spur further exploration, and added geological and production knowledge will lead to new exploration targets.

Along with the tangible benefits will be the intangible lift to industry confidence. Industry will welcome a demonstration that economic projects can be mounted in a hostile physical environment and under less than optimal business conditions.

It is possible that Canada's East Coast will experience the cyclical development that has been typical of other offshore operations. In the late 1960s, for example, oil prospects in the North Sea looked gloomy and there was a lull in activity until the discovery of the enormous Ekofisk and Forties fields. An exploration revival quickly proved vast reserves and the first wave of production followed. These successes inspired another round of exploration in the 1970s and the new expertise and infrastructure made smaller discoveries economically accessible.

There is every reason to believe that Hibernia and Terra Nova will provide the confidence and the industrial and technical foundation on which to build a mature East Coast oil community. Prolonged negotiations and then weakening prices delayed the exploitation of Grand Banks discoveries. Now, however, agreement on the nature of fiscal terms will permit the first key project to proceed, and development plans for the second are in an advanced stage of preparation. With them will come an important new dimension to the East Coast economy and a more secure energy future for Canada.

Petro-Canada is the leading player

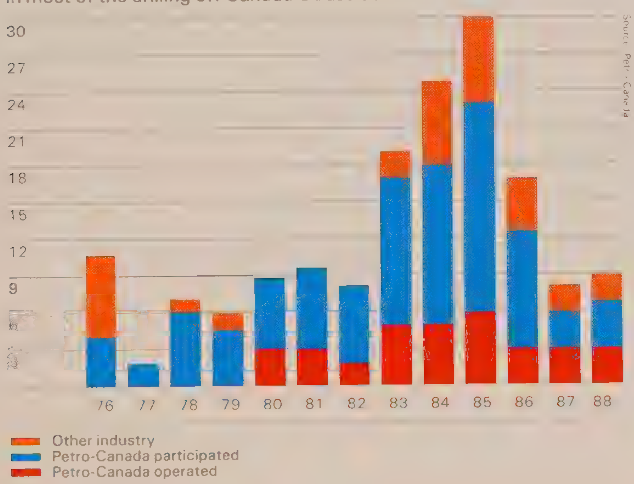
Thirteen years ago, when Petro-Canada was establishing itself in Calgary, exploration off Canada's East Coast was declining. Even though energy prices were rising rapidly, companies were relinquishing millions of acres as leases expired. Heavy investments had been made on exploration without a major discovery.

During the intervening years, a dramatic change has occurred. The Geological Survey of Canada estimates ultimate technically recoverable reserves off the East Coast to be about 12 billion barrels of oil and 86 trillion cubic feet of natural gas. Petro-Canada estimates the potential discovered oil reserves to be well over 2 billion barrels.

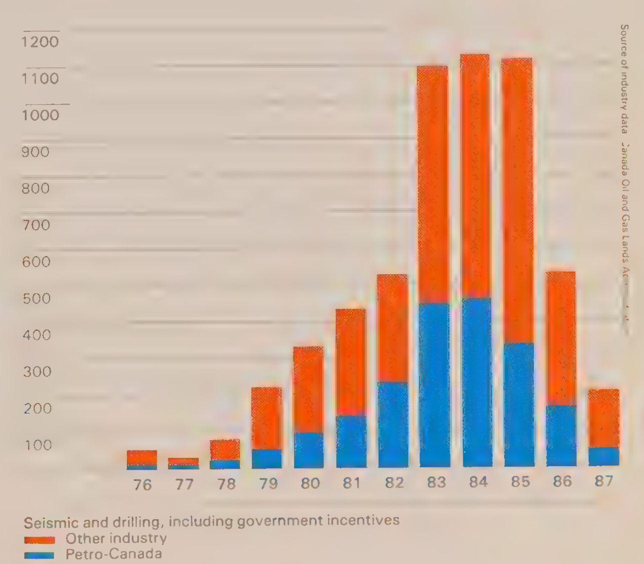
Petro-Canada has been a leader in turning the tide in favour of the East Coast offshore. The Corporation is a 25% partner in the Hibernia project. It discovered and operates the nearby Terra Nova field where it holds a 44% interest in the pre-development engineering phase. Petro-Canada has also participated in other Grand Banks discoveries such as Ben Nevis, West Ben Nevis and Hebron. On the Scotian Shelf, the Corporation has been a partner in Venture, Thebaud, Glenelg and other gas discoveries as well as the relatively small oil finds at Cohasset and Panuke. The Corporation's total probable and potential reserves in the various discoveries amount to 650 million barrels of oil and natural gas liquids and 2.5 trillion cubic feet of natural gas.

Since Petro-Canada began operations it has participated in 128 wells off the East Coast, or 80% of the industry total, and was the operator of 33 wells. Including government incentives, the Corporation has invested $2.2 billion on East Coast drilling and seismic expenditures, 36% of the industry total. Along the way, Petro-Canada has acquired the technology and expertise to emerge as a leading operator in the region, capable of attracting partnership deals with small Canadian companies as well as the largest multinationals.

Wells drilled
Since it was established, Petro-Canada has been involved in most of the drilling off Canada's East Coast



Expenditures (millions of dollars)
Petro-Canada's investments have spurred East Coast activity

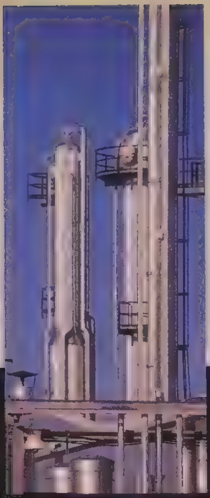


From an operational standpoint, 1988 was a successful year for the Resources Division. This performance was not, however, reflected in the financial results. The combined effect of low world oil prices, the rising Canadian dollar and weak natural gas prices reduced the margins from oil and gas production. Cash flow was $362 million and earnings were $48 million, both significantly down from 1987. Cash flow return on average capital employed was 8.9 per cent, a drop from 13.9 per cent in the previous year.

Financial and Operating Profile

Financial	1988	1987
Revenue (millions of dollars)	989	1 138
Earnings (millions of dollars)	48	162
Cash generated from operations (millions of dollars)	362	563
Capital expenditures (millions of dollars)	611	336
Average capital employed (millions of dollars)	4 358	4 155
Cash flow return on average capital employed (per cent)	8.9	13.9

Operating	1988	1987
Crude oil and field natural gas liquids production, net before royalties (thousands of m^3 per day)		
Conventional crude oil	10.0	10.1
Synthetic crude oil	4.1	3.7
Bitumen	0.5	0.5
Field natural gas liquids	2.1	2.1
Total	16.7	16.4
Natural gas production, net before royalties (millions of m^3 per day)	13.7	12.3
Natural gas liquids production from straddle plants including ethane (thousands of m^3 per day)	6.4	6.3
Proven reserves of crude oil and natural gas liquids, net before royalties (millions of m^3)	92.5	89.0
Reserves life index for crude oil and natural gas liquids (years)	15	15
Proven reserves of natural gas, net before royalties (billions of m^3)	97.9	96.9
Reserves life index for natural gas (years)	19	22



George Sinclair, Fred Bagley, Ed Anderson and Roger Lien are managers of district operations, reservoir engineering, exploration and production engineering. Petro-Canada employs cross-functional teams to provide better identification of opportunities, more efficient operations and a quicker pace of activity.

The Brazeau sour gas plant in west-central Alberta is being expanded to almost triple its present capacity.

With external factors having such an influence on the business, the Division focused its efforts on controllable factors that contribute to financial and operating performance. During 1988, production volumes were increased 12 per cent for natural gas, 2 per cent for field natural gas liquids and 10 per cent for synthetic crude oil. The expected decline of conventional crude oil production was held at less than 1 per cent of 1987 production.

Equally important during 1988 was stewardship of the Division's asset base. To support a strategic focus on Western Canada, land acquisitions and exploration drilling both increased. Drilling success ratios rose over 1987, and it is expected that reserves additions from exploration and development, when fully appreciated, will replace the Corporation's oil and natural gas production for the year. In addition, 4.0 billion cubic metres of proven gas reserves were purchased in 1988.

Resources Division strategies, consistent with those described in the 1987 Annual Report, continue to strengthen the asset base and optimize upstream cash contributions to the Corporation. These strategies are: building strength in natural gas, optimizing Western Canada conventional operations, developing new sources of crude oil and managing changes in the reserves base.

Building strength in natural gas

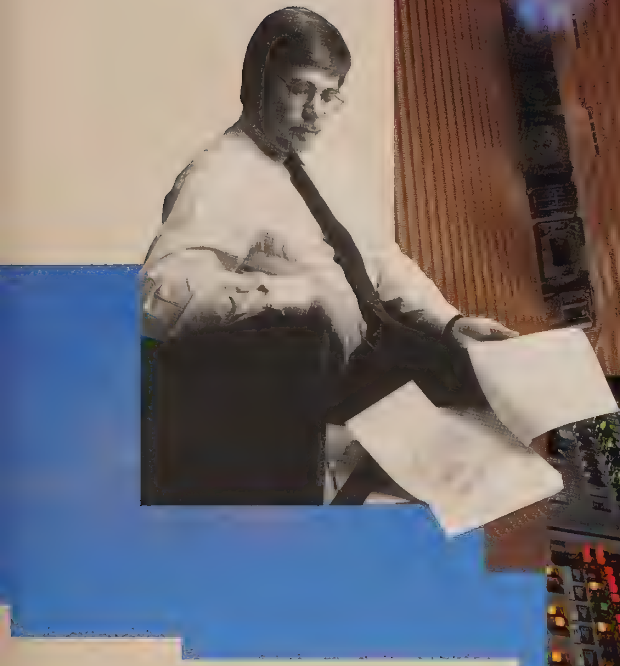
During 1988, there was a welcome increase in markets for Canadian natural gas. Furthermore, by year end the erosion of domestic and export natural gas prices had been turned around.

Improving markets, the restructuring of the industry following deregulation, and the strengthening of Petro-Canada's marketing and supply capabilities combined to boost the Corporation's gas sales to a record 15.5 million cubic metres per day. Over the last five years, Petro-Canada's share of total industry sales has increased from 5.3 per cent to 6.2 per cent.

Petro-Canada pursues direct sales to end-users, such as local distribution companies and industrial customers, in addition to traditional sales to marketing companies. Direct sales accounted for 13 per cent of the Corporation's 1988 gas sales, up from 4 per cent in 1987. Internal markets – Petro-Canada's refineries, enhanced recovery schemes and straddle plants – took another 17 per cent and the remaining 70 per cent went to marketing companies. Besides Petro-Canada's own production, sales included volumes produced by third parties.

Optimizing natural gas sales levels requires a careful balancing of production capability, third-party supply, processing and pipeline availability, and seasonal market requirements. During the year, Petro-

Petro-Canada's natural gas fuels boilers at the Northwood Pulp and Timber Ltd. mill, a direct industrial customer in Prince George, British Columbia.



John Halliwell is manager, contracts and supply, natural gas marketing.

Canada utilized storage at Carbon, Alberta, to maintain production levels during low-demand summer months and to handle deliveries during the winter period of peak demand and high prices. Additional measures to maximize asset productivity included: selecting appropriate markets for new, uncontracted gas supplies; utilizing Petro-Canada contracted pipeline space to capacity; and selling gas that is under contract to, but not taken by, marketing companies.

Petro-Canada increased its gas supplies in 1988 by taking advantage of some attractive opportunities to acquire proven reserves. Previously uncontracted gas volumes associated with the purchases, mostly in the Hanlan area of Alberta and around Hatton, Saskatchewan, were quickly brought on stream to meet specific direct and internal sales requirements. At Crane Lake, Saskatchewan, Petro-Canada drilled production wells, laid a gathering system, built a processing plant and began sending gas to market within four months of purchasing undeveloped gas reserves.

Natural gas sales have increased, with a growing share taken by direct and internal markets

Natural gas sales (millions of m³ per day)

Optimizing Western Canada conventional operations

Conventional operations remain at the centre of the Division's capital spending program. Sixty-four per cent of capital expenditures, or $393 million, was utilized to develop the existing asset base, and find or acquire additional conventional oil and natural gas in Western Canada.

Petro-Canada held production rates at high levels and added reserves through improved recovery processes and infill drilling. At the Bellshill Lake and Valhalla oilfields in Alberta, these measures maintained production and increased reserves. New waterflood programs in Saskatchewan increased proven reserves by 234 per cent at Salt Lake and Cactus Lake.

Petro-Canada's largest capital project initiated in 1988 was the expansion of the Brazeau sour gas plant in west-central Alberta. The plant is operated by Petro-Canada and upon completion of the project will be about 36 per cent owned by the Corporation. The total cost of the plant expansion project will be $66 million, or $21 million net to Petro-Canada. Construction began in October and is expected to be completed in late 1989. The decision to expand the plant to almost three times its present capacity was based on an analysis of production data that allowed accurate measurement of reserves in the very complex reservoir. The Corporation's share of additional production capacity will be 300 cubic metres of natural gas liquids, 160 cubic metres of ethane and 100 tonnes of sulphur per day.

The exploration focus this year was on gas, and the results were good. Among the promising exploration lands acquired were rights on the Wainwright military reserve in east-central Alberta. By year end Petro-Canada had completed nine gas wells. After further drilling and pipeline construction, production is planned for late 1989. Among other significant discoveries were the sour gas and liquids find at Sarcee, west of Calgary, and other gas wells in the Newby area of northeastern Alberta and at Doe Creek in northeastern British Columbia. The Corporation found oil reserves in the Shekilie area of north-western Alberta and the Hitchcock area of Saskatchewan. Overall, the exploration programs resulted in 35 gas wells and 20 oil wells, for a success ratio of 63 per cent.

Developing new sources of crude oil

Petro-Canada sees Canada's East Coast offshore as the country's next major oil supply region. As the leading industry player, the Corporation has developed an excellent position in the two most promising oil projects, Hibernia and Terra Nova.

Petro-Canada holds a 25 per cent interest in the Hibernia field, which is estimated to contain approximately 83 million cubic metres of recoverable reserves. In July, the Hibernia consortium of companies and the federal and provincial governments agreed to a Statement of Principles concerning fiscal terms for development of the field. Total capital spending over the 26-year life of the project is expected to be $8.5 billion, including about $5.2 billion in pre-production costs. Hibernia will reach an average production level of about 17 500 cubic metres of oil per day.

The Terra Nova offshore oilfield, located close to Hibernia, is another excellent development prospect. Petro-Canada discovered the field in 1984 and has since drilled seven delineation wells. Tests completed in July on the three most recent wells were very encouraging, suggesting probable reserves could exceed 21 million cubic metres. The results have led Petro-Canada – as operator and 44 per cent participant in the pre-development phase – to award a preliminary engineering contract to evaluate development options.

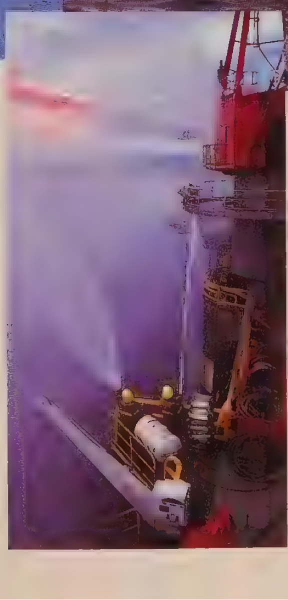
In the oil sands, Petro-Canada is a 15 per cent participant in the OSLO project. OSLO is a proposed 12 000 cubic metre per day integrated mining plant in northeastern Alberta, with estimated total pre-production costs of $4.1 billion. An agreement-in-principle was reached in September between the OSLO consortium and the federal and Alberta governments on fiscal terms relating to the venture. A two-year engineering program will begin in 1989 and, assuming the owners find the project economically viable, construction will follow.

Synthetic crude production at the Syncrude plant, in which Petro-Canada holds a 17 per cent interest, reached a record level for the fourth consecutive year. The Corporation's share of production was about 4 050 cubic metres per day. This record was achieved in part due to the commissioning of additional processing facilities during 1988. Unit operating costs were held steady but low prices for synthetic crude oil drastically cut margins.

At the Wolf Lake in situ oil sands facility, 50 per cent owned by Petro-Canada, construction of the project's second phase continued, slightly ahead of schedule and under budget. However, results in 1988 suffered from very low bitumen prices and production problems at the existing plant.

Petro-Canada continued its program of international exploration. Modest in scale, the program accounted for 4 per cent of the Division's capital expenditures in 1988. International exploration offers an excellent oppor-

The successful test of the Terra Nova C-09 delineation well has boosted reserves estimates for the Terra Nova oilfield.



Ken McDonald managed offshore drilling from St. John's, Newfoundland.

tunity to add to Petro-Canada's oil reserves at low to moderate cost. New petroleum concessions were negotiated in Pakistan, Malaysia and Colombia and arrangements were concluded to farm in on exploration ventures in Thailand, Colombia, Spain and China. The Corporation participated in drilling four wells during the year; one of these, in Colombia, was an onshore oil discovery.

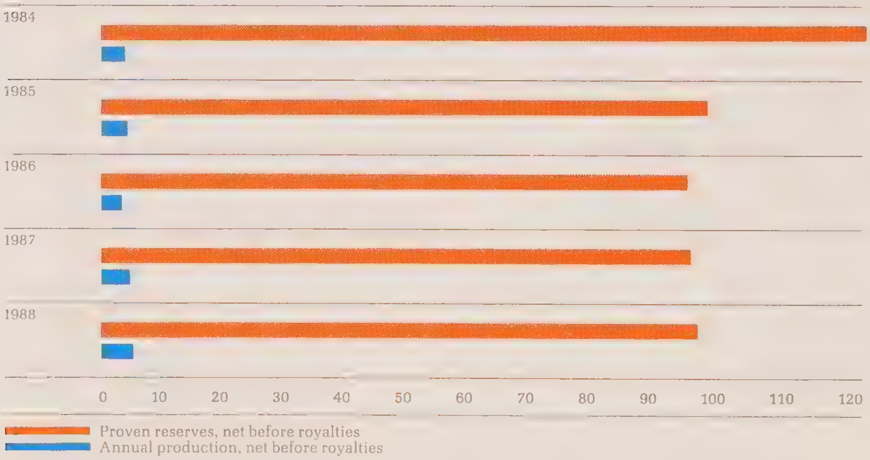
Managing changes in the reserves base

The Division's major asset base continues to be the conventional crude oil and natural gas reserves in Canada's Western Sedimentary Basin and this will likely be the case into the twenty-first century. However, Petro-Canada is increasingly reliant upon non-conventional resources in the Alberta oil sands, and recognizes the potential of conventional crude from the East Coast offshore and reserves that may be obtained through international exploration. Because of Western Canada's maturity as an exploration area, it is becoming more expensive to find economic quantities of the better-quality light and medium crude oils.

Petro-Canada's proven reserves are summarized in numerical form in the Reserves Information table and Five Year Operating Summary. Year-over-year decreases in conventional crude oil tend to reflect downward revisions of proven undeveloped reserves. This is counterbalanced by upward revisions in the proven reserves of synthetic crude oil. With changing conditions in natural gas markets, certain smaller, more isolated or geologically marginal fields were no longer found to be economically viable and they were removed from the proven reserves category. Fields

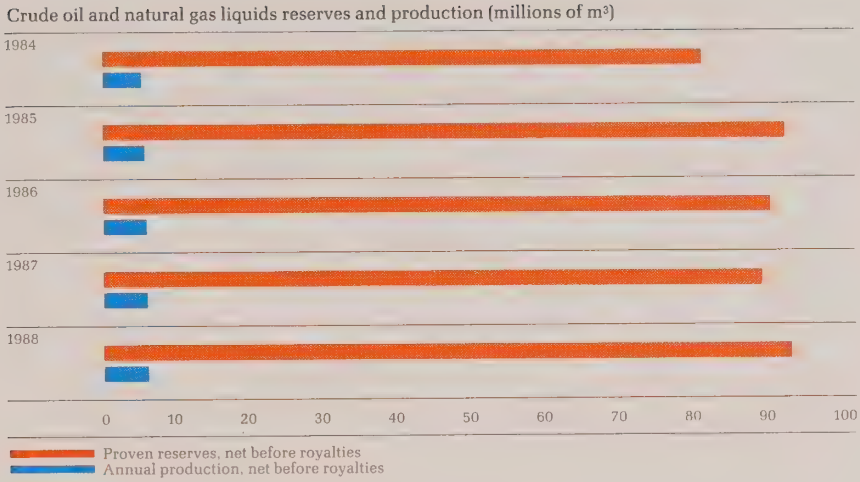
After a downward revision in 1985, reserves have remained steady; production has increased

Natural gas reserves and production (billions of m³)



Crude oil and natural gas liquids reserves and production have risen, holding the reserves life index at a steady level

Crude oil and natural gas liquids reserves and production (millions of m^3)



which currently are not technically and economically viable are treated as potential reserves and are not included in this report. For the time being, it has been decided to leave reserves associated with major frontier and oil sands development projects in the potential category until development is assured.

The proportion of the Corporation's reserves which are proven developed as opposed to proven undeveloped increased slightly between 1987 and 1988, reflecting the development work that has been done to bring oil and gas fields to production. The reserves life index for crude oil and natural gas liquids remained steady at 15 years. In spite of an increase in reserves, the reserves life index for natural gas dropped to 19 years due to an increase in production. Over 1988, additions of proven reserves were equal to 160 per cent of the year's production for crude oil and 116 per cent for natural gas. Replacing proven reserves in excess of production is a major accomplishment in the Western Canada basin where mature fields show rapid decline curves. This increase is the result of continuing efforts in exploration and development, revisions and purchases of proven reserves.

Altogether, Petro-Canada holds proven oil, gas and natural gas liquids reserves in approximately 400 fields in Western Canada. The six largest fields, Valhalla, Pembina, Bellshill Lake, Brazeau River, Nipisi and Cactus Lake, account for 47 per cent of conventional oil and natural gas liquids reserves. The top six natural gas fields, Hanlan, Yoyo, Whitecourt, Medicine Hat, Laprise Creek and Ricinus, comprise 35 per cent of the Corporation's natural gas reserves.

Results for the Products Division rose slightly from the previous year. Earnings were $102 million, a 7 per cent increase over 1987. Cash generated from operations was $311 million, down 6 per cent. The Division's return on average capital employed was 3.8 per cent, an improvement over 3.4 per cent in 1987. Although this recovery was small, industry-wide trends indicate some cause for optimism.

There has been some easing of the over-capacity problems which have reduced refining and marketing profitability in recent years. Demand for refined products was higher for the third consecutive year in both Canada and the United States. In addition, North American refining capacity declined due to operating changes associated with the phase-out of lead in gasoline. These two factors caused refinery utilization rates generally to rise, particularly for secondary or conversion units.

For Petro-Canada, these structural changes produced margin improvements on the wholesale side of the business. However, in retail operations, profitability was still limited in 1988 by several factors. Retail gasoline markets were still intensely competitive and volatile, particularly in Western Canada which experienced recurring price wars in 1988. With the higher promotional expenses needed to maintain volumes, competition squeezed retail margins severely.

Financial and Operating Profile

Financial	1988	1987
Revenue (millions of dollars)	4 245	4 461
Earnings (millions of dollars)	102	95
Cash generated from operations (millions of dollars)	311	330
Capital expenditures (millions of dollars)	159	122
Average capital employed (millions of dollars)	2 700	2 757
Return on average capital employed (per cent)	3.8	3.4

Operating	1988	1987
Petroleum product sales (thousands of m^3 per day)	43.8	45.6
Retail outlets at year end	3 429	3 677
Refinery crude capacity at year end (thousands of m^3 per day)	60.6	64.0
Crude oil processed by Petro-Canada (thousands of m^3 per day)	48.5	48.4
Average refinery utilization (per cent)	77	76

The introduction of the unleaded "Maximum" gasolines provides customers with three grades of superior, cleaner-burning fuel.

Sales representative Keith Eliuk, district manager Carole Emard and retail station manager Glen Robinson were members of a customer focus task force. This group has developed programs that will reorient the Division toward customers' needs.

Total refined product sales volumes were down 4 per cent compared to 1987, reflecting difficult price competition and the shedding of low-margin sales.

Products Division strategies, geared to increasing the profitability of the refining and marketing business, evolved and matured from those discussed in the 1987 Annual Report. They are: focusing on the customer, increasing revenue from existing assets, building a stronger lubricants business and refining more efficiently.

Focusing on the customer

Petro-Canada recognizes that the core of its downstream business is selling fuels and that earnings growth hinges on satisfying customers.

The Corporation continues to adapt its product offering to strengthen market share and expand further in high-margin market segments. This strategy recognizes the changing requirements of Canadian consumers and the strengths of Petro-Canada's research and manufacturing base.

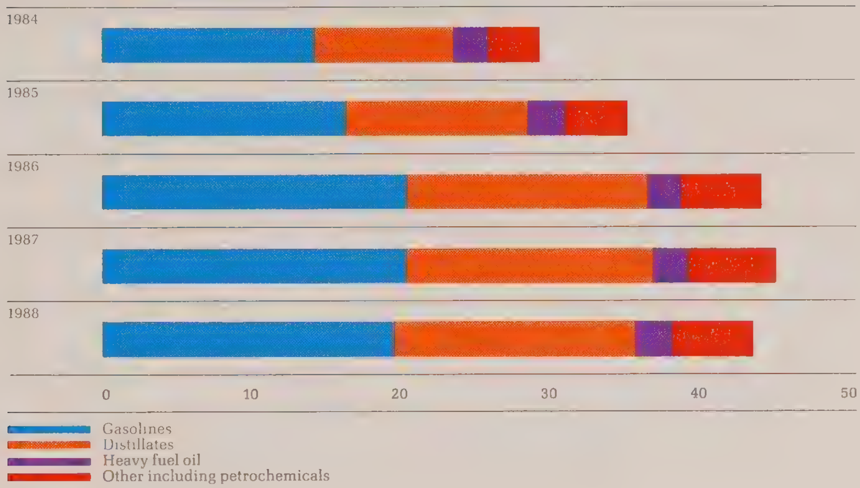
In September, Petro-Canada launched its "Maximum" family of unleaded gasolines, three grades of gasoline specially formulated to deliver improved fuel economy, power and longer engine life. These unleaded gasolines are a response to growing public awareness about air quality and the effects of lead in the environment, and the federal government's legislated deadline for removing lead from gasoline. By moving quickly in response to emerging trends, Petro-Canada has achieved an unrivalled position in the growing unleaded market.

"Maximum", "Maximum Plus" and "Maximum Supreme" allow Canadians to choose from three octane levels to match specific vehicle needs and driving conditions. Over 1 500 retail outlets offered "Maximum" gasoline by year end, and the remainder of the network will be converted in 1989.

For several years, programs and incentives have been implemented to improve service. Petro-Canada's toll-free customer service line, introduced in 1987, became operational nationwide during 1988. Any customer can contact the Corporation for information on retail products, services or credit. At year end, a specially trained staff of 20 was fielding over 25 000 inquiries per month, a mix of commendations, suggestions, queries and complaints.

During the year, installation of computerized credit authorization terminals was completed at over 2 500 high-volume retail outlets across the

Petroleum product sales (thousands of m^3 per day)



Total petroleum product sales declined 4 per cent in 1988

country. Retailers and customers have been enthusiastic in their evaluation of the terminals which can process credit card purchases faster, more accurately, and with greater security than before. For Petro-Canada, this program has reduced paperwork and led to speedier processing of accounts receivable.

After reviewing the wholesale marketing business from the perspective of customers, Petro-Canada introduced a computer system and software designed to allow bulk sales operators to become their own business managers. Wholesale associates can enhance their customer service by responding to specific local needs, such as in delivery arrangements, credit or associated services, and still offer a national line of quality products. The result for customers is closer relationships with more responsive businesses, while for the Corporation, working capital, overhead and operating costs are all reduced.

The wholesale invoicing system was improved in 1988. This lowered the error rate on industrial and commercial accounts by 50 per cent, leading to better service and faster turnaround on accounts receivable.

Petro-Canada held its position as the country's leading asphalt supplier, with approximately 35 per cent of the market. During the year, customer service was improved through the upgrading of asphalt terminals in Ontario.

Petro-Canada has developed innovative pricing mechanisms for medium and large industrial customers through the use of petroleum futures and options. The customer gains from budget certainty, lower administrative costs associated with firm prices, and the ability to lock in suitable prices. Petro-Canada benefits from committed sales at known margins.

These and other efforts to strengthen the relationship with consumers have produced some successes. However, a careful review of overall customer satisfaction concluded that results have been inconsistent across the Division. A clear opportunity has been identified to build market share by providing a level of customer satisfaction that would differentiate Petro-Canada from its competitors. Accordingly, a high-level task force has developed programs that will reorient the entire organization and its operations toward customers' needs. By year end, specific initiatives were planned to improve marketing leadership, build more direct links between all business groups and the retail front line, and place a renewed and deliberate focus on the fundamentals of the retail business.

Increasing revenue from existing assets

Petro-Canada offers retail customers several additional services that increase the revenue generated from existing sites and in turn promote greater gasoline sales. In 1988, the Division continued its implementation of three programs: car washes, convenience stores and the Certigard vehicle maintenance and repair franchises.

Particular emphasis was given to the expansion and further development of Certigard. By year end, 79 Certigard businesses were operating in major urban centres across Canada. Over 100 more are planned for 1989. In each case, franchisees offer motorists long-term, customized preventive maintenance. Key components of the program are a distinctive bay management system and personalized service, giving customers confidence in the quality of work performed and an understanding of future maintenance requirements and their costs.

Along with the growth in the number of Certigard businesses was the introduction in 1988 of supporting computer hardware and software.

The Certigard car care franchises were expanded further in 1988.

Chris Carruthers, manager of retail programs, is responsible for generating additional revenue from existing retail sites.

Besides its record-keeping, report-producing and diagnostic capabilities, the computer system reduces franchisees' costs with automated bookkeeping, payroll and accounting, and provides an electronic link with head office for information on vehicle parts, prices and maintenance.

Market research has indicated that consumers are looking for greater assurance that their vehicles will be maintained with long-term security and economy in mind. Training of franchisees and staff during the year emphasized how the Certigard program can best be used to satisfy these preferences. Additionally, advertising and promotion programs were carried out to make motorists aware of the benefits of this service.

Building a stronger lubricants business

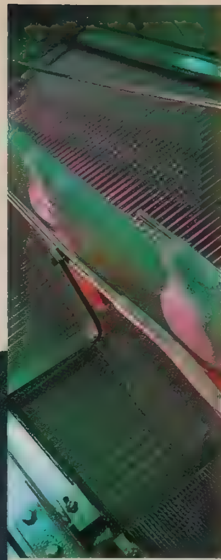
Petro-Canada has an excellent position in the lubricants business. The patented HydroTreating process at the Clarkson, Ontario, lubricants plant produces base stocks with a purity that is unique in Canada. Petro-Canada is increasing the financial contribution from lubricants by focusing more of its activity at the Sheridan Park Research and Development Centre toward lubricants product development and by more aggressive domestic and foreign marketing.

Over the last two years, earnings from lubricants were reduced as a result of a fire at the Clarkson plant in 1987. In the summer of 1988, a new first-stage HydroTreater became operational and Clarkson resumed full production of its 300 HydroTreated (HT) products and 1 350 product/package combinations.

Petro-Canada maintains its position as a leader in high-performance automotive and industrial lubricants. Product development teams continue to investigate market opportunities and formulate, test and launch new products that will enhance profits. A new product marketed in 1988, "Super Premium 5W30" motor oil, has received industry recognition for its superior low temperature properties, oxidation resistance and wear characteristics.

During the year, Petro-Canada gained entry into additional lubricants markets. Agreements were reached to provide factory fills of automatic transmission fluids and other HT-based lubricants for the Canadian plants of a number of Pacific Rim car manufacturers. Farther afield, a distributor began selling Petro-Canada branded gear oils, motor oils and transmission fluids in Japan's high-performance automotive market.

A new first-stage HydroTreater is now operational at the Clarkson lubricants plant. The plant produces lubricants of a quality unrivalled in Canada.



Bob Hodgson, general manager of lubricants, is responsible for improving the profitability of Petro-Canada's lubricants business.

Refining more efficiently

The Division's efforts to improve refinery utilization, reduce operating costs and meet lead phase-out targets, have involved refinery integration, computerization and equipment upgrading.

A major efficiency program – the integration of the Corporation's refineries at Edmonton, Alberta, and Port Moody, British Columbia – was completed in the last quarter of the year. Edmonton's processing facilities are highly efficient and produce an exceptionally high proportion of gasolines and diesels, with correspondingly low volumes of by-products such as heavy fuel oil. Taking advantage of this strength, a specially tailored feedstock stream is produced for pipeline transportation to Port Moody. At Port Moody, the refinery's excellent octane generation capability was retained. The crude unit was converted to handle the Edmonton feedstock, while other units deemed unnecessary were decommissioned. Synergies are made possible by the different capabilities of the two plants and distinct market requirements that result from weather and altitude variances.

An integration program with similar objectives is under way at Petro-Canada's Clarkson and Trafalgar refineries in Ontario where the facilities were recently placed under a single management. The interchange of feedstock and blending components between the two plants improves efficiency.

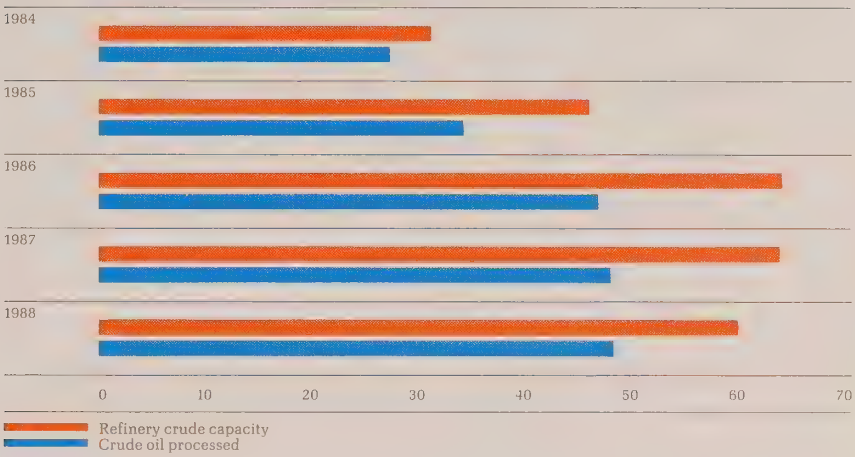
These integration measures helped increase average capacity utilization for the Corporation's refining network to 77 per cent from 76 per cent in 1987. In the last two months of the year, following completion of the Edmonton/Port Moody integration, network utilization rose to 80 per cent.

To satisfy increased demand for unleaded gasolines and meet lead phase-out targets, modifications are under way at several refineries. For instance, isomerization units are being installed at Edmonton and Clarkson at a total cost of approximately $120 million.

Capital spending on refinery computerization continued through 1988. Results will lower operating costs and improve yields of top-quality gaso-

In 1988, refinery capacity was reduced and crude oil processed held steady, thereby increasing refinery utilization

Refinery crude capacity and crude oil processed (thousands of m³ per day)



lines and distillates. Main plant computerization was completed at Edmonton, and at year end Petro-Canada decided to improve process control at the Trafalgar refinery through a major re-instrumentation program. At the Montreal refinery, the gasoline blending system is being upgraded and computerized to provide more stringent and cost-effective controls over product quality. The $20-million program will be completed in 1989.

From community to national programs, Petro-Canada continued its efforts to enrich the lives of Canadians.

The year will be memorable for the thousands of Canadians who participated in the XV Olympic Winter Games through the Olympic Torch Relay. Building from that success, Petro-Canada launched the Olympic Torch Scholarship Fund. Through it, young Canadians are encouraged to balance their pursuit of athletic excellence with the achievement of educational goals.

Promotional programs associated with the relay raised $4 million and provided the capital for the Scholarship Fund. Interest earned from the fund goes to scholarships granted each year to post-secondary students involved in Pan American or Olympic sports. Several awards are also made annually to individuals working toward a career in coaching. The first 100 recipients were announced by the Canadian Olympic Association in September.

For several years, Petro-Canada has emphasized sports and safety for children. For instance, 1 500 dealers and agents sponsored baseball teams in 1988, and the Right Riders program helped raise bicycle and road safety awareness among Canadian children of elementary school age.

Right Riders is the only national safety program of its kind. During the year 200 000 children participated in Petro-Canada's safety instruction sessions held at 39 exhibitions and fairs across Canada. A teaching kit on bicycle safety was added to the range of Right Riders activities in 1988. Officers from over 200 police forces assisted in presenting the materials to 13 600 schools and an estimated audience of more than four million children. The Right Riders program receives assistance, cooperation and

Responding to legislation and public concern about the environment, Petro-Canada introduced "Maximum" lead-free gasolines.

From high art to comedy, Petro-Canada sponsors cultural events across the country.

Teaching road safety to children remains a priority.

endorsement from police forces, provincial safety associations, ministries of education and the Traffic Injury Research Foundation.

Petro-Canada has also taken steps to ensure the broadest range of Canadians has an opportunity to work for the Corporation, and that its employees are treated with fairness and respect. During 1988, Petro-Canada continued to implement its comprehensive employment equity policy. The policy is designed to ensure the fair treatment of current and prospective employees in four designated groups: women, disabled persons, visible minorities and aboriginal peoples. Related initiatives include establishing a child care facility for Calgary-based employees, a company-wide policy prohibiting sexual harassment, a native education awards program, and a youth employment program targeting unemployed young people. The Corporation also runs a special, university-level recruitment program among aboriginal and disabled persons studying in industry-related disciplines.

In 1988 Petro-Canada re-focused its commitment to the environment. A new environmental protection policy drew employees' attention to the importance of environmental issues in all of the Corporation's operations.

Public concern over air quality and health was a key consideration in introducing Petro-Canada's "Maximum" line of unleaded gasolines. Other new initiatives in the Products Division were the development within each refinery of a community awareness and emergency response program, and the inclusion of environmental and safety material in operations manuals delivered to all wholesalers. During the year, $9.7 million was spent on an extensive program to upgrade underground storage tanks at wholesale and retail sites throughout the country.

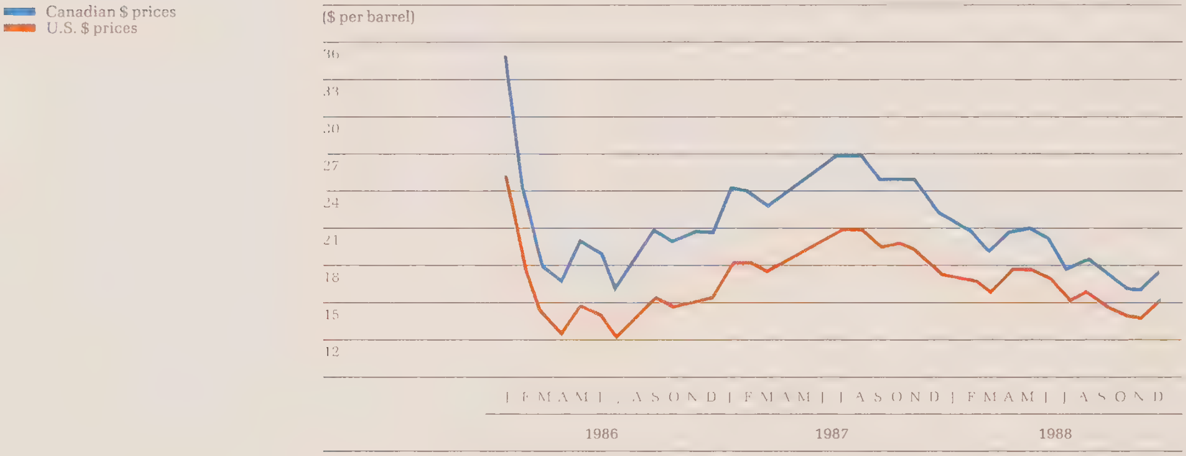
In the Resources Division, environmental considerations were prominent in the planning of all new exploration and production activity. For instance, development of Petro-Canada's newly acquired gasfield at Crane Lake, in south-western Saskatchewan, was contingent upon protecting the delicate ecology of the Sand Hills area. Saskatchewan Government officials approved the plans as environmentally responsible and indicated satisfaction with the way in which they had been followed by Petro-Canada employees and contractors.

As 1988 ended, years of preparation were completed for "*The Struggle for Democracy*" television series. In 1983, Petro-Canada approached the respected journalist, Patrick Watson, to assist in developing a first-rate series on a topic of significant public interest. Petro-Canada provided advance funds to sponsor the project. The completed work was presented on national television in early 1989.

Business conditions difficult and volatile

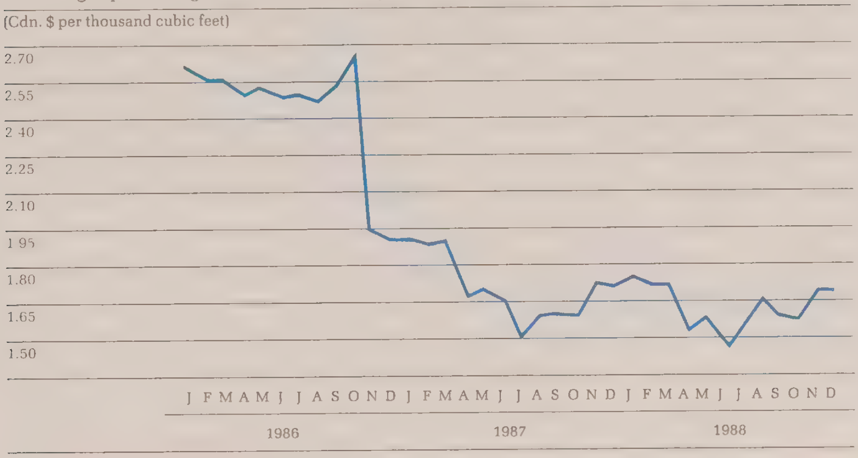
Petro-Canada's financial results declined in 1988 largely due to lower crude oil prices. Volatility and uncertainty continue to characterize world oil markets. In 1988, the combination of dropping world prices and a strengthened Canadian dollar caused Canadian oil prices to reach a low of $15 (U.S. $13) before recovering at the end of the year. Over the last three years, crude oil prices averaged Cdn. $21 in 1986, $25 in 1987 and $19 in 1988. Natural gas prices continued at depressed levels. Although there was some recovery by year end, Alberta field-gate natural gas prices averaged approximately Cdn. $1.63 per thousand cubic feet in 1988 versus Cdn. $1.71 in 1987. The combination of these factors, slightly offset by increased natural gas sales, caused oil and gas production revenues to fall during 1988.

Crude oil prices*
The decline in world oil prices and a stronger Canadian dollar combined to depress Canadian oil prices to very low levels in 1988.



*U.S. $ prices based on average NYMEX prices (one month forward) for West Texas Intermediate at Cushing.
Canadian $ prices are based on average NYMEX prices (one month forward) for West Texas Intermediate at Edmonton.

Natural gas prices*
Natural gas prices began a modest recovery after hitting a nine-year low in 1988.



*based on industry average of Alberta field-gate prices

Financial results down

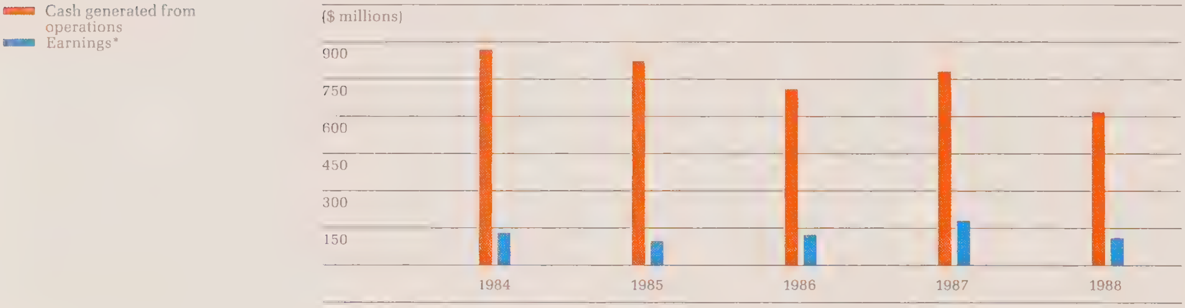
Net earnings after redeemable preferred share dividends were $94 million in 1988, down 45 per cent from $172 million in 1987. This drop reflects the impact of lower crude oil and natural gas liquids prices and a $22 million extraordinary write-down of the investment in Sedpex Inc. Resources Division earnings decreased from $162 million in 1987 to $48 million in 1988. Products Division earnings increased marginally from $95 million to $102 million. Corporate and other activities resulted in a loss of $24 million comparing favourably to a loss of $44 million in 1987. This improvement was largely related to the realization of deferred profit in inventory due to lower crude oil prices and foreign exchange gains resulting from the strengthening of the Canadian dollar.

Cash generated from operations of $613 million in 1988 was down 21 per cent from $778 million a year earlier. Cash generated by the Resources Division decreased substantially from $563 million in 1987 to $362 million in 1988. Cash contributions from the Products Division decreased slightly from $330 million in 1987 to $311 million in 1988.

Capital expenditures of $799 million were 65 per cent above the 1987 level of $483 million with the increase in investment, including reserves acquisitions, being directed in large part to the Resources Division. The

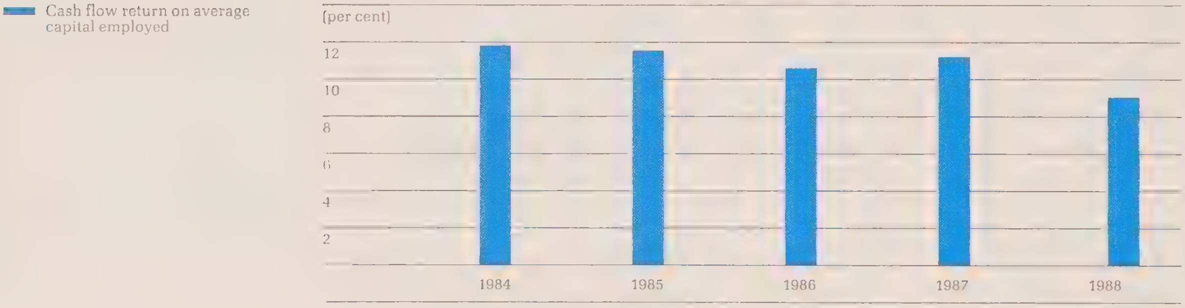
investment in working capital in 1988 decreased by $203 million, primarily as a result of lower crude costs in the Products Division; this compared to an increase in working capital in 1987 of $244 million. Average capital employed by the Corporation in 1988 amounted to $7 718 million, compared to $7 353 million a year earlier. Cash flow return on average capital employed decreased from 11.3 per cent in 1987 to 9.2 per cent in 1988, due to the generally lower prices for oil and natural gas.

Cash generated from operations versus earnings*
Cash flow was reduced to $613 million by the combined effect of weak crude oil and natural gas prices and a stronger Canadian dollar. Earnings declined 33 per cent from 1987.



*before extraordinary and unusual items and after dividends on redeemable preferred shares

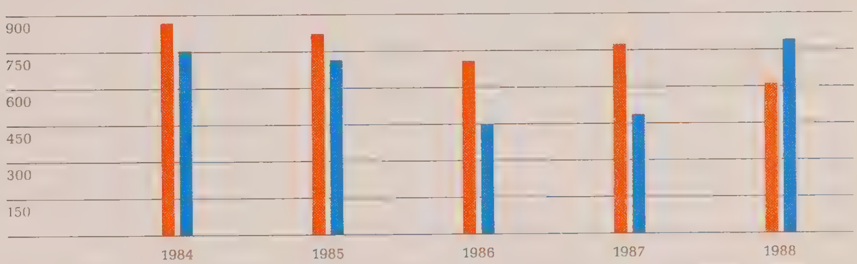
Profitability
Difficult business conditions resulted in a lower cash flow return on average capital employed.



Investment activities reflect business opportunities

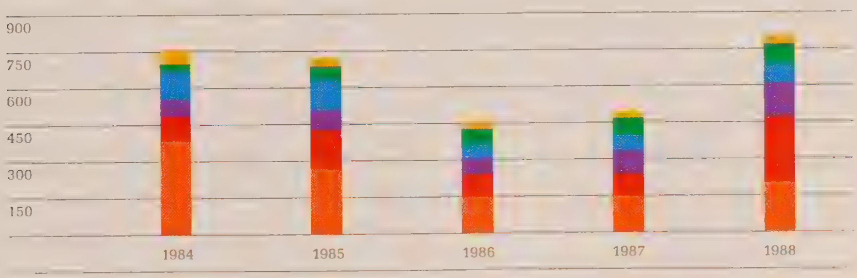
Capital expenditures were increased in 1988 to take advantage of opportunities for enhanced short-term cash flow, while interests in promising, longer-term development projects were maintained. In particular, the focus on conventional oil and gas properties in Western Canada was continued from 1987, with additional funds devoted to purchases of natural gas reserves. Capital expenditures in the refining and marketing business were also increased in 1988, with the objective of improving refining efficiency and upgrading the marketing network. The Corporation continues to invest within the framework of current and prospective levels of cash generated internally from operations and changes in working capital. Capital expenditures for conventional activities in Western Canada were approximately $129 million for exploration and $264 million for development. Spending in frontier and international areas was $80 million and in oil sands $138 million. Capital expenditures for refining and marketing totalled $159 million.

Cash flow and reinvestment
Attractive investment opportunities, including the purchase of natural gas reserves, led to a high reinvestment level in 1988.



	1984	1985	1986	1987	1988
Reinvestment ratio	.87	.86	.63	.62	1.30

Components of capital spending
Capital expenditures continued to focus on the upstream, with emphasis shifting from exploration to development.



Preserving financial integrity

Financial coverage and leverage ratios generally declined in 1988 as a result of difficult business conditions. However, at year end, the Corporation's measure of debt to capital improved to 35.0 per cent from 35.7 per cent at the end of 1987 because investments were closely matched to internally generated cash. Cash flow to debt declined in 1988 from 37.0 to 29.1 per cent as a result of reduced cash flow. Interest coverage stood at 2.4 times at the end of 1988.

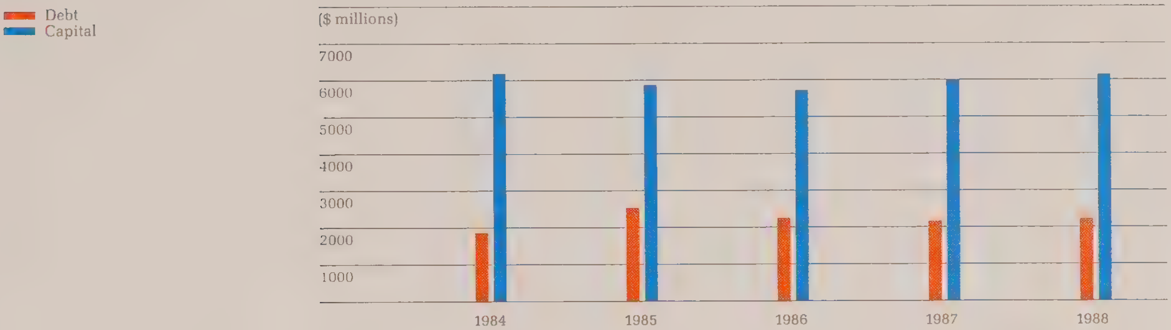
During 1988, the Corporation redeemed the remaining redeemable preferred shares at a cost of $883 million. The redemption was financed by new long-term debt issues of $361 million and additional short-term debt. The new long-term debt issues lengthened the average maturity of the Corporation's outstanding long-term debt and diminished financial obligations during the early to mid-1990s when major developments will require considerable investment capital. As a result of the share redemption, dividends of $10 million paid on redeemable preferred shares in 1988 were $31 million lower than in 1987. Interest expense of $131 million was $58 million higher than in the previous year reflecting the refinancing of redeemable preferred shares with debt and generally higher interest rates.

The Corporation remains committed to maintaining the integrity of its financial structure. Cash generated from current activities continues to be sufficient to finance significant ongoing capital investments, and to fulfil Petro-Canada's current fixed financial obligations without undue reliance on external funds.

Considerable additional external financing will, however, be required for the Corporation to proceed with major new development projects. Petro-Canada's participation in Hibernia, and its continuing interest in other megaproject developments, will involve substantial financing commitments in future years. Special financing arrangements offered by governments to support such developments will significantly increase Petro-Canada's capability to undertake such ventures without jeopardizing its financial structure. However, caution will be required, given the uncertain business environment expected over the next few years and the long lead-times typical of megaprojects. The financing of new commitments will be carefully planned to avoid undue levels of financial risk and safeguard the Corporation's financial position.

Financial position

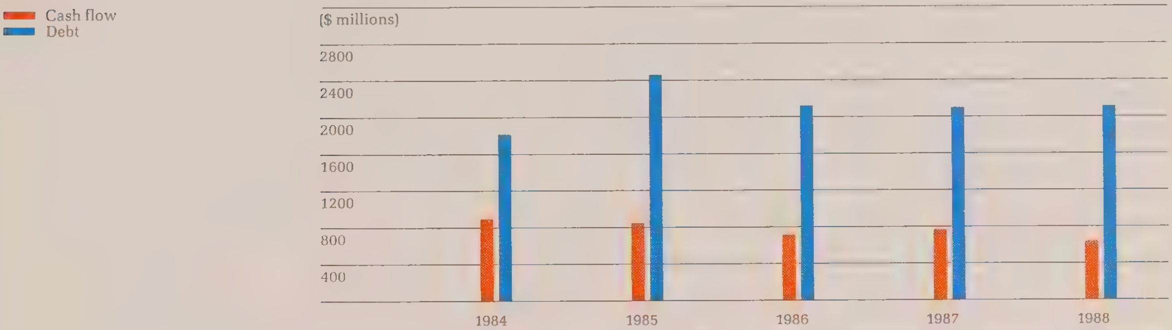
The ratio of debt to capital continued to improve as debt levels were held constant in 1988.



	1984	1985	1986	1987	1988
Ratio	29.6	41.8	37.4	35.7	35.0

Cash flow to debt

A significant reduction in cash flow in 1988 caused a decline in this financial indicator.



	1984	1985	1986	1987	1988
Ratio	48.0	33.8	33.5	37.0	29.1

Capital	Shareholder's equity plus debt. Shareholder's equity reflects the valuation of redeemable preferred shares at year-end U.S. $/Cdn. $ exchange rates.
Capital employed	Total assets less current liabilities excluding short-term notes payable and the current portion of long-term debt. Average capital employed is the average of the current year's and previous year's year-end capital employed.
Capital expenditures	Expenditures on property, plant and equipment less Petroleum Incentive Program grants.
Cash flow return on average capital employed	Working capital provided from operations as disclosed in the financial statements plus tax adjusted interest expense plus investment tax credits divided by average capital employed.
Cash flow to debt	Cash generated from operations divided by debt.
Cash generated from operations	Internally generated cash from operations as disclosed in the financial statements less dividends on redeemable preferred shares.
Debt	Long-term debt including the current portion of long-term debt, short-term notes payable, outstanding cheques less cash, advances on future natural gas deliveries and redeemable preferred shares valued at year-end U.S. $/Cdn. $ exchange rates.
Debt to capital	Debt divided by capital.
Interest coverage	Earnings before interest expense, provision for income taxes, extraordinary and unusual items, and dividends on redeemable preferred shares divided by interest expense plus capitalized interest plus dividends on redeemable preferred shares multiplied by 1/1 – tax rate.
Reinvestment ratio	Capital expenditures divided by cash generated from operations.
Return on average capital employed	Earnings before extraordinary and unusual items and dividends on redeemable preferred shares plus tax adjusted interest expense divided by average capital employed.
Return on average shareholder's equity	Earnings before extraordinary and unusual items and after dividends on redeemable preferred shares divided by average shareholder's equity. Average shareholder's equity reflects the valuation of redeemable preferred shares at year-end U.S. $/Cdn. $ exchange rates.

Petro-Canada

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The financial statements have been prepared by management in accordance with generally accepted accounting principles appropriate in the circumstances. Management is responsible for the other information in the Annual Report, which is consistent, where applicable, with that contained in the financial statements. Management is also responsible for installing and maintaining a system of internal control to provide reasonable assurance that reliable financial information is produced. The Corporation has an internal audit department whose functions include reviewing the system of internal control to ensure that it is adequate and functioning properly.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, a majority of which is composed of directors who are not employees of the Corporation. The committee meets with management, the internal auditors and the external auditors to satisfy itself that responsibilities are properly discharged and to review the financial statements.

The external auditors conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their examination includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board.

AUDITORS' REPORT

To the Honourable Jake Epp, P.C., M.P.
Minister, Energy, Mines and Resources Canada
House of Commons, Ottawa, Ontario

We have examined the consolidated balance sheet of Petro-Canada (incorporated by Special Act of the Parliament of Canada) as at December 31, 1988 and the related consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1988 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Further, we have examined the transactions of the Corporation and its consolidated wholly owned subsidiaries that came to our notice in the course of the above mentioned examination, to determine whether they were in accordance with Part X of the Financial Administration Act, the regulations, the charter and by-laws of the Corporation and its consolidated wholly owned subsidiaries and any directives given to the Corporation pursuant to the Act. Our examination of these transactions was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. In our opinion, these transactions were, in all significant respects, in compliance with the authorities specified.

Calgary, Alberta
February 20, 1989

Arthur Andersen & Co.
Chartered Accountants

Petro-Canada

CONSOLIDATED BALANCE SHEET

As at December 31, 1988
(stated in millions of dollars)

Assets	1988	1987
Current Assets		
Cash and short-term deposits	$ 84	$ 10
Accounts receivable	734	892
Inventories (Note 2)	560	721
Income taxes recoverable	36	4
Prepaid expenses	41	53
	1 455	1 680
Investments (Note 3)	539	509
Property, Plant and Equipment, net (Note 4)	6 534	6 197
Deferred Charges (Note 5)	83	67
	$ 8 611	$ 8 453

Approved on behalf of the Board

Director

Director

Liabilities and Shareholder's Equity	1988	1987
Current Liabilities		
Short-term notes payable	$ 968	$ 313
Accounts payable and accrued liabilities	765	864
Current portion of long-term debt	6	6
	1 739	1 183
Long-Term Debt (Note 6)	1 036	744
Deferred Credits (Note 7)	213	190
Deferred Income Taxes	1 708	1 633
Redeemable Preferred Shares (Note 8)	–	831
Shareholder's Equity (Note 9)	3 915	3 872
	$ 8 611	$ 8 453

CONSOLIDATED STATEMENT OF EARNINGS

For the year ended December 31, 1988
(stated in millions of dollars)

	1988	1987
Revenue		
Operating	$ 4 669	$ 4 982
Investment and other income	132	97
	4 801	5 079
Expenses		
Crude oil and product purchases	1 939	2 214
Marketing, general and administrative	891	819
Producing and refining	777	727
Depreciation, depletion and amortization	428	412
Federal sales and other taxes	383	394
Interest on long-term debt	71	59
Other interest	60	14
	4 549	4 639
Earnings before Undernoted Items	252	440
Provision for Income Taxes (Note 10)		
Deferred	74	164
Current	52	63
	126	227
Earnings before Extraordinary Item and Dividends on Redeemable Preferred Shares	126	213
Extraordinary Item (Note 11)	22	–
Net Earnings before Dividends on Redeemable Preferred Shares	104	213
Dividends on Redeemable Preferred Shares (Note 8)	10	41
Net Earnings after Dividends on Redeemable Preferred Shares	$ 94	$ 172

Petro-Canada

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

For the year ended December 31, 1988
(stated in millions of dollars)

	1988	1987
Retained Earnings (Deficit) at Beginning of Year	$ (289)	$ (450)
Net earnings before dividends on redeemable preferred shares	104	213
Dividends on redeemable preferred shares	(10)	(41)
Exchange adjustment on redemption of redeemable preferred shares	(51)	(11)
Retained Earnings (Deficit) at End of Year	$ (246)	$ (289)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

For the year ended December 31, 1988
(stated in millions of dollars)

	1988	1987
Internally Generated Cash		
Working capital provided from operations (Note 12)	$ 624	$ 784
Proceeds from sale of property, plant and equipment	22	46
Advances on future natural gas deliveries	(23)	(11)
Internally generated cash from operations	623	819
Decrease (increase) in operating working capital (Note 13)	203	(244)
	826	575
Investment Activities		
Expenditures on property, plant and equipment	799	483
Increase in investments, net	52	142
Increase in deferred charges, net	18	1
	869	626
Financing Activities and Dividends		
Increase in short-term notes payable, net	655	313
Proceeds from issue of long-term debt	361	–
Redemption of redeemable preferred shares	(883)	(102)
Dividends on redeemable preferred shares	(10)	(41)
Reduction of long-term debt	(6)	(21)
	117	149
Increase in Cash	74	98
Cash and Short-Term Deposits (Deficiency) at Beginning of Year	10	(88)
Cash and Short-Term Deposits at End of Year	$ 84	$ 10

Note 1: Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada, an agent of Her Majesty in right of Canada, and of all subsidiary companies ("the Corporation") except Canertech Inc., which is excluded for the reason described in Note 3.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition is attributed to the related assets acquired and is amortized over the life of these assets.

(b) Inventories

Inventories are stated at the lower of cost and net realizable value. Cost of crude oil, refined products and merchandise is determined on a "first-in, first-out" basis.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity method. Other long-term investments are accounted for on the cost method.

(d) Property, Plant and Equipment

The Corporation accounts for its investment in oil and gas properties on the full cost method whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, drilling both productive and non-productive wells and overhead related to exploration and development. Separate cost centres have been established for each country in which the Corporation has an interest in oil and gas properties. The Corporation applies a "ceiling test" to each of its producing oil and gas cost centres to ensure that such costs do not exceed the total of the estimated future net revenues from production of proven reserves, the unimpaired costs of certain projects in Canadian frontier areas and the unimpaired costs of unevaluated properties. The estimate of future net revenues is based upon prices and operating costs in effect at the balance sheet date. In addition a consolidated ceiling test provides for future administrative overhead, financing costs and income taxes.

Costs are accumulated separately for the Syncrude Project, producing in situ and other oil sands leases. Overburden removal costs relating to oil sands which will be mined in future years are deferred and are charged to earnings when the related oil sands are mined.

Substantially all of the Corporation's exploration and production activities are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

The interest cost of debt attributable to the construction of major new facilities is capitalized during the construction period.

(e) Depreciation, Depletion and Amortization

Costs incurred in producing oil and gas cost centres, other than unimpaired costs of certain projects in Canadian frontier areas and of unevaluated properties, and costs incurred on the Syncrude Project and producing in situ oil sands leases are depreciated or depleted separately on the unit of production method based on estimated proven recoverable oil and gas reserves before royalties. For purposes of calculating depreciation and depletion, natural gas production and reserves are converted to equivalent units of crude oil based on the relative energy content of each commodity.

Costs incurred in non-producing oil and gas cost centres and other oil sands leases are subject to review for impairment. Any impairment is charged to earnings. When exploration proves to be

(stated in millions of dollars)

Note 1: (Continued)

successful, and economic viability has been established, the unimpaired balance is depleted on the unit of production method when production commences.

Depreciation of other plant and equipment is provided on either the unit of production method or the straight line method as appropriate. Straight line depreciation rates are based on the estimated service lives of the related assets.

(f) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming depreciation, exploration, development and other costs for income tax purposes which differ from the related amounts charged to earnings.

(g) Translation of Foreign Currency

Current assets, except inventories and prepaid expenses, current liabilities and long-term debt are translated at rates of exchange in effect at the balance sheet date. Long-term assets, inventories, prepaid expenses, deferred income taxes, redeemable preferred shares and revenue and expense items are translated at rates of exchange in effect at the respective transaction dates. Depreciation, depletion and amortization expense reflects rates of exchange in effect when the related assets were acquired.

The resulting exchange gains or losses are included in earnings, except for unrealized exchange gains or losses arising on translation of long-term debt, which are deferred and amortized over the remaining term of the debt, and realized losses on redemption of redeemable preferred shares, which are charged directly to retained earnings.

Foreign operations are integrated with the Corporation's other activities and are translated in the manner described above.

Note 2: Inventories

	1988	1987
Crude oil, refined products and merchandise	$ 495	$ 657
Materials and supplies	65	64
	$ 560	$ 721

Note 3: Investments

	1988	1987
At equity		
Westcoast Energy Inc.	$ 269	$ 219
Petro-Canada Centre	189	188
Sedpex Inc.	18	38
Other	22	20
At cost		
Mortgages and other investments	41	44
	$ 539	$ 509

Westcoast Energy Inc. ("Westcoast")

At December 31, 1988 the Corporation held approximately 37% (1987–31%) of the outstanding common shares of Westcoast with a quoted market value of $280 million (1987–$250 million).

(stated in millions of dollars)

Note 3: (Continued)

Petro-Canada Centre

The Corporation holds 50% of a joint venture which owns Petro-Canada Centre, an office complex in Calgary. The Corporation has entered into a long-term lease for use of a portion of the complex and, as at December 31, 1988, has guaranteed $135 million of long-term debt related to the facility.

Sedpex Inc.

The Corporation holds 50% of the outstanding common shares of Sedpex Inc., a company which owns a semi-submersible drilling vessel.

Canertech Inc. ("Canertech")

The accounts of Canertech, a wholly-owned subsidiary company, have been excluded from consolidation because a formal plan exists to dispose of the investment in the subsidiary. In response to a directive by the Government of Canada, the Corporation incorporated Canertech in 1981 to develop alternate energy sources. At that time the Government indicated its intention of purchasing the Corporation's investment at cost and establishing Canertech as an independent Crown corporation. The Corporation is proceeding with the implementation of a Government directive to bring about the dissolution of Canertech. The Corporation's investment in Canertech is carried in the accounts at its original cost of one dollar.

Note 4: Property, Plant and Equipment

	1988			1987	Capital Expenditures	
	Cost	Accumulated Depreciation, Depletion and Amortization	Net	Net	1988	1987
Natural resources						
Oil and gas						
Canada	$ 5 657	$ 2 194	$ 3 463	$ 3 250	$ 441	$ 239
Foreign						
–producing	67	49	18	19	3	–
–non-producing	133	106	27	17	23	12
Oil sands						
Syncrude Project	751	153	598	577	42	44
Producing in situ	221	21	200	115	91	30
Other oil sands	212	212	–	–	5	5
Natural gas liquids	210	89	121	128	4	2
Other	105	81	24	29	2	4
	7 356	2 905	4 451	4 135	611	336
Refining and marketing	2 495	550	1 945	1 921	159	122
Other property, plant and equipment	299	161	138	141	29	25
	$ 10 150	$ 3 616	$ 6 534	$ 6 197	$ 799	$ 483

At December 31, 1988, $3 250 million (1987–$3 074 million) of Canada oil and gas net costs were subject to depreciation and depletion.

Capital expenditures for the year include $12 million (1987–$7 million) of capitalized interest expense.

(stated in millions of dollars)

Note 5: Deferred Charges

	1988	1987
At cost		
Oil sands overburden removal costs	$ 39	$ 40
Less portion related to oil sands to be mined within one year	17	16
	22	24
Deferred pension funding	27	13
At amortized cost		
Deferred financing costs	17	14
Other	17	16
	$ 83	$ 67

Note 6: Long-Term Debt

	Maturity	1988	1987
In Canadian dollars			
8.25% unsecured notes	1993	$ 11	$ 11
In United States dollars			
7.75% unsecured notes (U.S.$13 million)	1993	15	18
LIBOR less 0.8% unsecured notes (U.S.$125 million)	1995	149	162
9% unsecured notes (U.S.$26 million)	1995	31	39
7.25% unsecured debentures (U.S.$200 million)	1996	239	260
9.50% unsecured debentures (U.S.$200 million)	2003	239	–
8.25% unsecured debentures (U.S.$200 million)	2016	239	260
9.70% unsecured debentures (U.S.$100 million)	2018	119	–
		1 042	750
Less current portion		6	6
		$ 1 036	$ 744

Repayment of long-term debt

The minimum repayment of long-term debt in each of the next five years is as follows:
1989–$6 million 1990–$6 million 1991–$7 million 1992–$7 million 1993–$24 million

(stated in millions of dollars)

Note 7: Deferred Credits

	1988	1987
Advances on future natural gas deliveries	$ 95	$ 118
Translation adjustment on long-term debt	88	33
Long-term liabilities	30	39
	$ 213	$ 190

Note 8: Redeemable Preferred Shares

During 1988 a subsidiary redeemed 7 092 983 shares (1987–779 000 shares) for a consideration of U.S. $709 million (1987–U.S. $78 million). The 1988 redemption comprised virtually all the remaining outstanding shares.

Note 9: Shareholder's Equity

Authorized Capital

(a) 71 188 common shares with a par value of one hundred thousand dollars each, and

(b) Preferred shares issued to the Government of Canada provided that the amount of such shares together with any loans received, and outstanding, from the Consolidated Revenue Fund of the Government of Canada is not in excess of one billion dollars. These shares have a par value of one dollar each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

Issued (to the Government of Canada)

	Number of Shares	1988	1987
Common Shares	31 883	$ 3 188	$ 3 188
Preferred Shares	972 771 853	973	973
Total Capital at Beginning and End of Year		4 161	4 161
Deficit at End of Year		(246)	(289)
		$ 3 915	$ 3 872

(stated in millions of dollars)

Note 10: Income Taxes

The provision for income taxes of $126 million (1987–$227 million) represents an effective rate of 50% (1987–51.6%) on earnings before income taxes of $252 million (1987–$440 million). The computation of the provision, which requires adjustment to earnings before income taxes for non-taxable and non-allowable items, is as follows:

	1988	1987
Earnings before income taxes	$ 252	$ 440
Add (deduct)		
Royalties and other payments to provincial governments	135	160
Federal allowances		
Resource allowance	(107)	(144)
Tax depletion	(38)	(36)
Non-deductible depreciation, depletion and amortization	88	99
Non-taxable gains	(14)	(10)
Equity in earnings of affiliates	(21)	(25)
Other	4	(8)
Earnings as adjusted before income taxes	$ 299	$ 476
Canadian Federal income tax at 42.4% (1987–46.6%) applied to earnings as adjusted	$ 127	$ 222
Provincial and other income taxes, net of federal abatement	4	9
Provincial income tax rebates	(5)	(4)
Provision for income taxes	$ 126	$ 227

Note 11: Extraordinary Item

Due to uncertain dayrates and low utilization of offshore drilling rigs, the Corporation has written down the carrying value of its investment in Sedpex Inc. (Note 3). The amount of this charge to earnings is $22 million including related income taxes of $2 million.

Note 12: Working Capital Provided from Operations

	1988	1987
Earnings before extraordinary item and dividends on redeemable preferred shares	$ 126	$ 213
Add (deduct)		
Depreciation, depletion and amortization	428	412
Deferred income taxes	74	164
Equity earnings, net of dividends received	2	(4)
Other	(6)	(1)
	$ 624	$ 784

(stated in millions of dollars)

Note 13: Decrease (Increase) in Operating Working Capital

	1988	1987
Accounts receivable	$ 158	$ (18)
Inventories	161	(168)
Income taxes recoverable	(32)	16
Prepaid expenses	12	(18)
Accounts payable and accrued liabilities	(99)	(69)
Other	3	13
	$ 203	$ (244)

Operating working capital is comprised of working capital other than cash and short-term deposits, short-term notes payable and current portion of long-term debt.

Note 14: Pension Plans

The Corporation's plans are defined benefit plans with the benefits generally based upon years of service and average salary during the final years of employment. They are funded by the Corporation based upon the advice of an independent actuary.

Plan Status as at December 31

	1988	1987
Actuarial value of assets	$ 445	$ 394
Pension obligation	427	382
Net pension asset	$ 18	$ 12

The net pension asset is amortized to earnings over the expected average remaining service life of the employees covered by the plans, which is currently 13 years.

Pension funding and expense amounted to $32 million (1987–$32 million) and $16 million (1987–$17 million) respectively.

Note 15: Related Party Transactions

Transactions with the Government of Canada and its agencies are in the normal course of business and are therefore on the same terms as those accorded to non-related parties.

(stated in millions of dollars)

Note 16: Segmented Information

The Corporation operates in two business segments:

Natural resources, comprising: exploration, development, production, transportation and marketing activities for crude oil, natural gas, field liquids, sulphur and oil sands; and extraction of liquids from natural gas.

Refining and marketing, comprising: purchase and sale of crude oil; refining crude oil into oil products; and distribution and marketing of these and other purchased products.

Financial information by business segment is presented in the following table as though each segment were a separate business entity. Inter-segment transfers of products, which are accounted for at market value, are eliminated on consolidation. Corporate and other includes investment income, interest expense and unallocated general corporate revenues and expenditures. Corporate and other assets are principally cash and short-term deposits, investments in other companies and general corporate assets.

	Natural Resources		Refining and Marketing		Corporate and Other		Consolidated	
	1988	1987	1988	1987	1988	1987	1988	1987
Revenue								
Sales to customers and other revenues	$ 473	$ 571	$ 4 245	$ 4 461	$ 83	$ 47	$ 4 801	$ 5 079
Inter-segment sales	516	567	–	–	–	–		
Segment revenue	$ 989	$ 1 138	$ 4 245	$ 4 461	$ 83	$ 47		
Earnings								
Operating earnings before depreciation, depletion and amortization	$ 415	$ 623	$ 336	$ 327	$ 60	$ (25)	$ 811	$ 925
Depreciation, depletion and amortization	(280)	(266)	(142)	(139)	(6)	(7)	(428)	(412)
Interest	–	–	–	–	(131)	(73)	(131)	(73)
Provision for income taxes	(87)	(195)	(92)	(93)	53	61	(126)	(227)
Earnings (loss) before extraordinary item and dividends on redeemable preferred shares	$ 48	$ 162	$ 102	$ 95	$ (24)	$ (44)	$ 126	$ 213
Capital expenditures								
Property, plant and equipment	$ 611	$ 336	$ 159	$ 122	$ 29	$ 25	$ 799	$ 483
Investments	–	–	1	–	51	142	52	142
Deferred charges	(1)	(8)	2	(4)	17	13	18	1
	$ 610	$ 328	$ 162	$ 118	$ 97	$ 180	$ 869	$ 626
Total assets	$ 4 729	$ 4 431	$ 3 101	$ 3 436	$ 781	$ 586	$ 8 611	$ 8 453
Capital employed	$ 4 509	$ 4 207	$ 2 585	$ 2 815	$ 752	$ 567	$ 7 846	$ 7 589

Note 17: Comparative Figures

Certain reclassifications have been made to the 1987 comparative figures to conform with the current year's presentation.

Note 18: Commitments and Contingencies

(a) Commitments
The Corporation has leased property and equipment under various long-term operating leases for periods up to 2008. The minimum annual rentals for non-cancellable operating leases are estimated at $53 million in 1989, $52 million in 1990, $45 million in 1991, $45 million in 1992, $39 million in 1993 and $19 million per year thereafter until 2008.

(b) Contingencies
The Corporation is involved in litigation and claims associated with normal operations. Management is of the opinion that any resulting settlements would not materially affect the financial position of the Corporation.

CONVERSION TABLE

1 cubic metre	=	6.29 barrels
1 cubic metre	=	35.31 cubic feet
1 litre	=	0.22 imperial gallons
1 hectare	=	2.47 acres
1 tonne	=	2 205 pounds
1 kilometre	=	0.62 miles

RESERVES INFORMATION

(proven reserves, net after royalties)

	1988 Developed	1988 Undeveloped	1988 Total	1987 Developed	1987 Undeveloped	1987 Total
Crude oil and natural gas liquids (thousands of m^3)						
Conventional crude oil	29 809	2 042	31 851	27 373	2 097	29 470
Synthetic crude oil	31 531	3 216	34 747	29 865	3 906	33 771
Bitumen	1 325	3 307	4 632	1 265	3 399	4 664
Natural gas liquids	5 237	624	5 861	4 447	977	5 424
Total	67 902	9 189	77 091	62 950	10 379	73 329
Natural gas (millions of m^3)	59 104	20 150	79 254	57 873	20 350	78 223

	1988 Oil (thousands of m^3)	1988 NGL (thousands of m^3)	1988 Gas (millions of m^3)	1987 Oil (thousands of m^3)	1987 NGL (thousands of m^3)	1987 Gas (millions of m^3)
Balance, beginning of year	67 905	5 424	78 223	68 041	5 263	77 323
Revisions of previous estimates	7 571	1 055	916	3 678	741	4 142
Extensions and discoveries	349	–	964	637	–	386
Purchases/sales	–	–	3 229	–	–	–
Production	(4 595)	(618)	(4 078)	(4 451)	(580)	(3 628)
Balance, end of year	71 230	5 861	79 254	67 905	5 424	78 223

Notes:

1. Reserves quantities in the Annual Report, excluding synthetic crude oil, are reported based on estimates consistent with the knowledge of the characteristics and extent of underlying productive formations at each year end.
2. The above figures include Petro-Canada's 17% interest in the synthetic crude oil reserves of Syncrude. These reserves are based on the demonstrated production capacity of the Syncrude plant and an estimate of the incremental production attributable to the capital program which was completed in 1988, both calculated over the remaining term of the current operating permit to the year 2013.

The Syncrude project is subject to a royalty agreement between the Province of Alberta and the Syncrude participants whereby the Province has the right to 50% of Syncrude's deemed net profit. The Province has an option to convert its royalty to a 7.5% gross overriding royalty.

The net after royalty reserves of Syncrude are based on an estimated average royalty rate for the life of the project using current prices and operating costs.

FIVE YEAR FINANCIAL SUMMARY
(stated in millions of dollars)

	1988	1987	1986	1985	1984
Summary of Earnings					
Revenue	$ 4 801	$ 5 079	$ 5 172	$ 5 381	$ 4 988
Expenses	4 549	4 639	4 741	4 868	4 376
	252	440	431	513	612
Add (deduct)					
Provision for income taxes	(126)	(227)	(249)	(341)	(385)
Minority interest	–	–	–	2	5
Earnings before extraordinary and unusual items and dividends on redeemable preferred shares	126	213	182	174	232
Extraordinary and unusual items	22	–	–	865	–
Net earnings (loss) before dividends on redeemable preferred shares	104	213	182	(691)	232
Dividends on redeemable preferred shares	10	41	59	78	100
Net earnings (loss) after dividends on redeemable preferred shares	$ 94	$ 172	$ 123	$ (769)	$ 132
Other Financial Data					
Cash generated from operations	$ 613	$ 778	$ 711	$ 828	$ 868
Expenditures on property, plant and equipment	799	488	614	1 059	1 131
Petroleum Incentive Program grants	–	5	166	349	380
Acquisitions including minority interests	–	–	301	1 010	(2)
Total assets	8 611	8 453	8 139	8 846	8 966
Average capital employed	7 718	7 353	7 226	7 746	7 780
Working capital (deficiency)	(284)	497	448	397	905
Long-term debt (Note 3)	1 042	750	818	289	157
Redeemable preferred shares	–	831	922	1 224	1 312
Shareholder's equity	3 915	3 872	3 711	3 642	4 478
Annual Operating Revenues					
Resources Division					
Crude oil and natural gas liquids					
Conventional crude oil	$ 307	$ 413	$ 336	$ 613	$ 585
Synthetic crude oil	166	192	167	279	214
Bitumen	9	19	13	14	–
Field natural gas liquids	46	57	50	80	67
	528	681	566	986	866
Natural gas	222	203	219	292	284
Sulphur	23	25	31	34	27
Natural gas liquids from straddle plants	152	145	192	235	246
Other	64	84	72	89	116
Total	$ 989	$ 1 138	$ 1 080	$ 1 636	$ 1 539

	1988	1987	1986	1985	1984
Annual Operating Revenues (Continued)					
Products Division					
Gasolines	$ 2 050	$ 2 240	$ 2 280	$ 2 232	$ 1 814
Distillates	1 284	1 384	1 549	1 350	1 025
Other including petrochemicals	911	837	759	768	592
Total	$ 4 245	$ 4 461	$ 4 588	$ 4 350	$ 3 431
Expenditures on Property, Plant and Equipment					
Resources Division					
Exploration					
Frontier	$ 54	$ 41	$ 245	$ 442	$ 601
Western provinces	129	101	62	145	128
Foreign	23	12	11	19	30
Development					
Western provinces	264	108	99	166	104
Foreign	3	–	1	6	6
Oil Sands					
Syncrude	42	44	47	60	31
Other	96	35	17	30	53
	611	341	482	868	953
Products Division					
Refining	80	49	55	115	90
Marketing	79	73	57	50	33
	159	122	112	165	123
Support facilities	29	25	20	26	55
	799	488	614	1 059	1 131
Petroleum Incentive Program grants	–	5	166	349	380
Total	$ 799	$ 483	$ 448	$ 710	$ 751
Reinvestment ratio	1.30	0.62	0.63	0.86	0.87
Financial Indicators (per cent)					
Performance					
Return on average capital employed	2.6	3.4	3.0	2.4	3.1
Cash flow return on average capital employed	9.2	11.3	10.7	11.7	11.9
Return on average shareholder's equity	3.0	4.7	3.5	2.5	3.2
Leverage					
Interest coverage (times)	2.4	3.2	2.6	2.8	2.9
Debt plus redeemable preferred shares to capital	35.0	35.7	37.4	41.8	29.6
Cash flow to debt plus redeemable preferred shares	29.1	37.0	33.5	33.8	48.0

Notes:
1. Financial and operating results are included from October 1, 1985 for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and April 1, 1986 for the operations of the Edmonton refinery.
2. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
3. Long-term debt includes current maturities.

FIVE YEAR OPERATING SUMMARY

	1988	1987	1986	1985	1984
Oil and Gas Landholdings (gross/net)					
(millions of hectares)					
Canadian provinces					
Alberta – Oil and natural gas rights	2.2/1.0	2.2/1.1	2.3/1.1	2.6/1.2	3.0/1.4
– Oil sands rights	1.0/0.3	1.0/0.4	1.1/0.4	1.0/0.4	0.9/0.3
British Columbia	0.9/0.5	0.9/0.5	1.1/0.6	1.4/0.7	1.3/0.7
Saskatchewan	0.3/0.2	0.2/0.1	0.2/0.2	0.2/0.1	0.2/0.1
Other provinces	0.1/0.1	0.1/0.1	0.1/0.1	0.2/0.1	0.3/0.2
	4.5/2.1	4.4/2.2	4.8/2.4	5.4/2.5	5.7/2.7
Frontier Canada	6.5/4.7	8.0/5.4	14.2/8.0	33.2/16.5	41.6/20.5
International	3.9/1.5	1.3/0.7	1.2/0.5	3.4/1.1	2.8/0.4
Total	14.9/8.3	13.7/8.3	20.2/10.9	42.0/20.1	50.1/23.6
Wells Drilled (gross/net)					
Canadian provinces – exploratory wells					
Oil	20/14	20/11	21/13	42/30	65/45
Gas	35/26	10/6	34/15	50/27	25/11
Dry	33/22	35/25	42/24	75/53	74/47
	88/62	65/42	97/52	167/110	164/103
Canadian provinces – development wells					
Oil	176/91	199/74	283/51	482/169	344/134
Gas	90/39	45/27	32/10	47/26	16/6
Oil sands	266/133	75/38	4/2	-/-	193/96
Dry	15/7	20/13	14/7	48/21	24/10
	547/270	339/152	333/70	577/216	577/246
Frontier Canada and international					
- exploratory and development wells					
Oil	3/2	3/1	9/2	16/4	9/2
Gas	1/0	-/-	9/3	10/4	9/2
Dry	8/2	6/2	19/6	26/7	25/8
	12/4	9/3	37/11	52/15	43/12
Total	647/336	413/197	467/133	796/341	784/361
Proven Reserves					
(net, before royalties/after royalties)					
Natural gas (billions of m^3)	97.9/79.3	96.9/78.2	96.7/77.3	98.8/77.9	120.4/100.4
Sulphur (millions of tonnes)	5.7/4.8	5.4/4.6	5.2/4.4	5.5/4.6	4.8/4.0
Crude oil and natural gas liquids					
(millions of m^3)					
Conventional crude oil	39.4/31.9	37.2/29.5	38.9/30.1	41.3/30.4	48.1/34.3
Synthetic crude oil	40.9/34.7	39.7/33.8	39.2/33.3	39.1/33.2	25.4/21.6
Bitumen	4.8/4.6	4.9/4.6	4.9/4.6	4.5/4.3	1.1/1.0
Natural gas liquids	7.4/5.9	7.2/5.4	7.1/5.3	7.5/5.5	6.4/4.7
Total	92.5/77.1	89.0/73.3	90.1/73.3	92.4/73.4	81.0/61.6

	1988	1987	1986	1985	1984
Daily Production					
(net, before royalties/after royalties)					
Natural gas (millions of m³)	13.7/11.1	12.3/9.9	10.2/8.2	11.6/9.1	10.8/9.0
Sulphur (thousands of tonnes)	1.0/0.8	1.0/0.8	0.9/0.8	0.9/0.8	1.4/1.2
Crude oil and field natural gas liquids (thousands of m³)					
Conventional crude oil	10.0/8.1	10.1/8.1	10.1/8.0	10.1/7.7	10.7/7.8
Synthetic crude oil	4.1/4.0	3.7/3.6	3.5/3.4	3.5/3.1	2.3/2.1
Bitumen	0.5/0.5	0.5/0.5	0.6/0.6	0.2/0.2	–/–
Field natural gas liquids	2.1/1.6	2.1/1.6	2.1/1.5	1.8/1.3	1.5/1.1
Total	16.7/14.2	16.4/13.8	16.3/13.5	15.6/12.3	14.5/11.0
Natural gas liquids production from straddle plants including ethane (thousands of m³)	6.4	6.3	6.5	5.7	6.3
Average sales prices					
Crude oil and field natural gas liquids ($ per m³)	102	140	115	227	213
Natural gas ($ per thousand m³)	57	57	75	87	88
Marketing					
Retail outlets at year end	3 429	3 677	3 844	3 965	2 485
Petroleum product sales (thousands of m³ per day)					
Gasolines	19.4	20.3	20.3	16.3	13.9
Distillates	16.1	16.7	16.2	12.2	9.6
Heavy fuel oil	2.6	2.5	2.4	2.6	2.4
Other including petrochemicals	5.7	6.1	5.5	4.4	3.9
Total	43.8	45.6	44.4	35.5	29.8
Refining					
Refinery crude capacity at year end (thousands of m³ per day)	60.6	64.0	64.0	46.2	31.6
Crude oil processed by Petro-Canada (thousands of m³ per day)	48.5	48.4	47.2	34.2	27.6
Average refinery utilization (per cent) (Note 3)	77	76	74	78	86
Employees					
Number at year end	7 373	7 204	7 740	9 747	6 798

Notes:
1. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentations.
2. Operating results are included from October 1, 1985 for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986 for the operations of the Edmonton refinery.
3. Average refinery utilization takes into account, where applicable, changes in refinery crude capacity that occurred during the year.

BOARD OF DIRECTORS

†* **Wilbert (Bill) H. Hopper**
Chairman of the Board
and Chief Executive Officer
Petro-Canada
Calgary, Alberta

† **Edward M. Lakusta**
President
and Chief Operating Officer
Petro-Canada
Calgary, Alberta

* **Robin Abercrombie**
Consultant
Roberts Creek Resources Ltd.
West Vancouver, B.C.
(resigned May 1988)

† **Alfred E. Barroll**
Consultant
A.E. Barroll Resource
Consultants Ltd.
Calgary, Alberta

Rudolph P. Bratty, Q.C.
Senior Partner
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(resigned March 1988)

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Walter P. Twinn
Sawridge Indian Band
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Petro-Canada Products Division
(retired January 1989)

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Barry D. Stewart
President
Petro-Canada Products Division
(appointed January 1989)

Wesley R. Twiss
Senior Vice-President,
Finance and Planning
(appointed January 1989)

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Litho Canada

1989 Annual Report

Growth and higher profitability are our goals

PETRO-CANADA

Corporate Profile

Petro-Canada is Canada's national petroleum corporation. Formed by an Act of Parliament in 1975, it is wholly owned by the Government of Canada. Operations began in January 1976. In February 1990, the Government announced its intention to privatize the Corporation.

Petro-Canada operates in a commercial fashion, competing in today's oil and gas industry on the same basis as other integrated energy companies. It is the largest Canadian-owned oil and gas company, with assets of almost $7 billion and revenue of $5 billion in 1989.

Petro-Canada has 6 468 employees, organized into two operating divisions along with a small corporate staff. Petro-Canada Resources, the "upstream" business, explores for, produces and markets crude oil, natural gas and natural gas liquids. The "downstream" business, Petro-Canada Products, refines crude oil, distributes and markets petroleum products and offers customers related goods and services.

Contents

March 23, 1990

The Honourable
Jake Epp, P.C., M.P.
Minister
Energy, Mines and
Resources Canada
House of Commons
Ottawa, Ontario

Dear Minister:

On behalf of the Board of Directors, I am pleased to present Petro-Canada's Annual Report for the fiscal year ended December 31, 1989.

In accordance with the provisions of the Financial Administration Act, the Report includes the consolidated financial statements together with the auditors' report thereon.

Yours sincerely,

W.H. Hopper
Chairman of the Board
and Chief Executive Officer

This Annual Report constitutes management's discussion and analysis of Petro-Canada's financial condition and results of operations. It includes a detailed review of the far-reaching changes the Corporation is making to improve its competitive position. This year's graphic approach deliberately emphasizes the accountability for, and the expectations arising from, the initiatives that are underway.

Shares of Petro-Canada will be offered to the Canadian public

On February 20, 1990, the Minister of Finance, the Honourable Michael Wilson, indicated in his budget speech that the Government of Canada would proceed with the privatization of Petro-Canada.

On the following day, the Honourable John McDermid, Minister of State for Privatization, announced in the House of Commons that, once necessary legislative and regulatory steps have been taken, the Board of Directors of Petro-Canada will be asked initially to offer a treasury issue of about 15 per cent of the Company.

Other details of the announcement were as follows:

- Legislation will allow for the sale of all Petro-Canada shares. They will be offered in a manner that ensures broad participation in the ownership of the Company.
- The Board of Directors of Petro-Canada will develop an employee share ownership program as part of the initial offering.
- Individual ownership will be limited to 10 per cent and foreign ownership to 25 per cent of the publicly held shares of Petro-Canada.
- The Minister of State for Privatization will retain the Government's holdings and manage them as an investment. The Government's overriding principle will be that Petro-Canada operate as a private-sector company with an arms-length relationship with the Government.
- Petro-Canada's headquarters will remain in Calgary. The Company will continue to adhere to the Employment Equity Act and existing internal policies governing salaries, pensions, benefits, official languages and relationships with the unionized workforce.

Highlights

Financial	1989	1988
Net earnings (loss) after extraordinary item and dividends on redeemable preferred shares (millions of dollars)	**31**	(43)
Working capital provided from operations (millions of dollars)	**569**	624
Expenditures on property, plant and equipment and exploration (millions of dollars)	**567**	799
Cash flow return on capital employed (per cent)	**11.0**	11.7
Return on capital employed (per cent)	**3.2**	1.1
Return on equity (per cent)	**3.1**	(0.8)
Average capital employed (millions of dollars)	**5 965**	5 969
Shareholder's equity (millions of dollars)	**2 758**	2 727

Operating	1989	1988
Crude oil and field natural gas liquids daily production, net before royalties (thousands of barrels)	**100**	105
Natural gas daily production, net before royalties (millions of cubic feet)	**571**	488
Crude oil processed per day (thousands of cubic metres)	**46.5**	48.5
Petroleum products sales per day (thousands of cubic metres)	**44.4**	43.8

Units of measurement

To conform with common usage, imperial units of measurement are used in this report to describe exploration and production while metric units are used for refining and marketing. Dollars are Canadian unless otherwise stated.

1 barrel	=	0.159 cubic metre	1 cubic metre	=	6.29 barrels
1 cubic foot (natural gas)	=	0.028 cubic metre	1 cubic metre (natural gas)	=	35.31 cubic feet
1 imperial gallon	=	4.55 litres	1 litre	=	0.22 imperial gallon
1 acre	=	0.405 hectare	1 hectare	=	2.47 acres
1 ton (long)	=	1.016 tonnes	1 tonne	=	0.984 ton (long)
1 mile	=	1.609 kilometres	1 kilometre	=	0.62 mile

This was a year of change for Petro-Canada. We have taken decisive steps, moving the Corporation onto a new path that will raise financial performance over time to the level of industry leaders.

Chairman and Chief Executive Officer
Bill Hopper

Petro-Canada did not do well financially in 1989, even though earnings were up. Net earnings were $31 million, after an extraordinary charge of $54 million; this was $74 million above the previous year's loss of $43 million. Working capital provided from operations of $569 million was down 9 per cent from 1988. Crude oil production slipped in 1989 although, in contrast, natural gas volumes hit a new high, increasing by 17 per cent. Sales of refined petroleum products were up slightly compared to a year earlier.

During 1989, the Corporation changed from the full cost to the successful efforts method of accounting for upstream operations. Successful efforts is a more conservative accounting approach, which we believe more appropriately reflects the maturity of Petro-Canada's upstream operations. Comparing Petro-Canada's financial statements to those of major competitors is now easier.

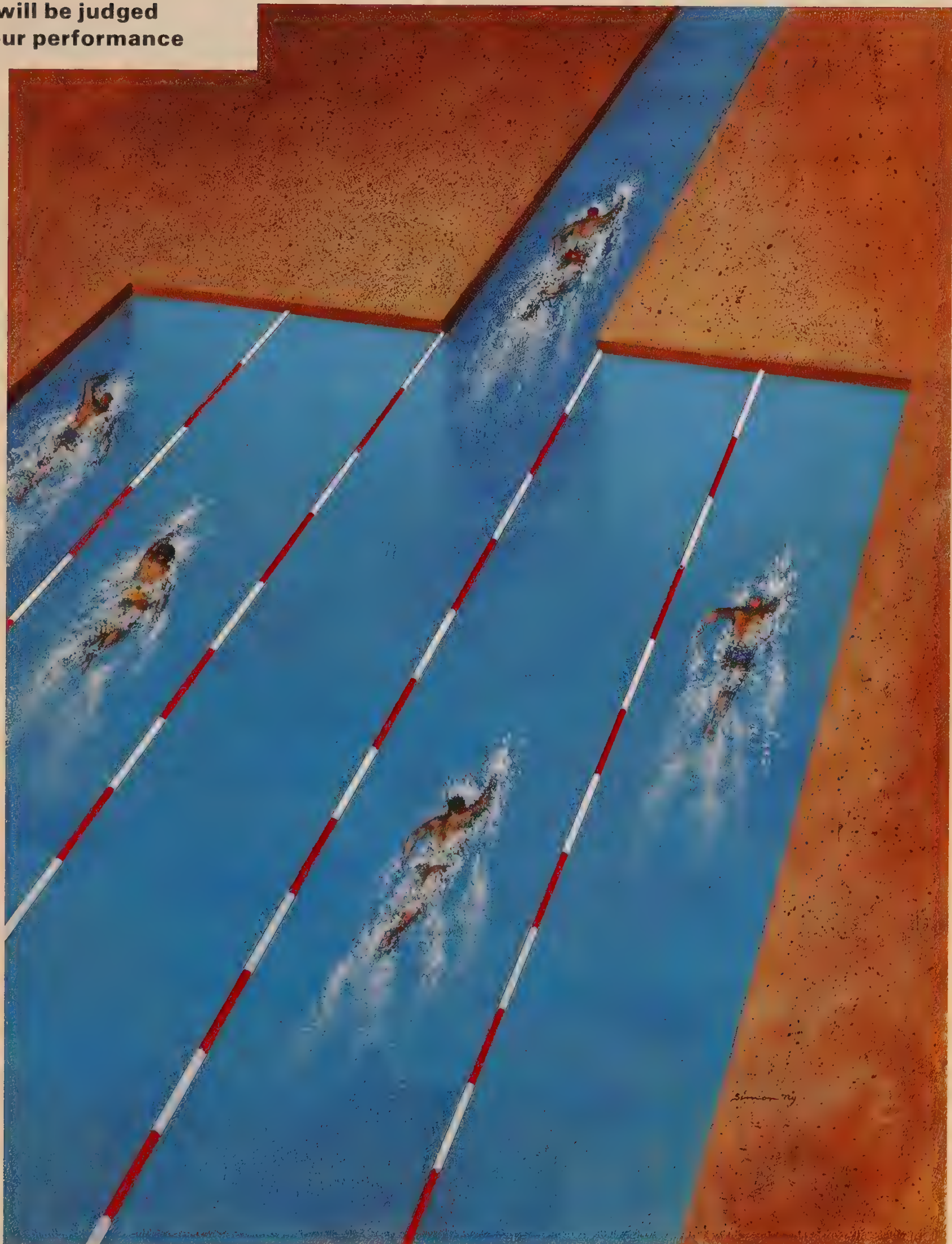
It is five years since the federal energy minister instructed Petro-Canada to operate in a private-sector fashion. Accordingly, the Corporation ceased its policy-driven activities and only followed commercial objectives and strategies. These were oriented in part to realizing the potential of several frontier and oil sands interests, the results of successful investments during earlier years. While these interests provide Petro-Canada with excellent prospects for earnings and growth, they also weight the Corporation's asset portfolio disproportionately toward the long term without contributing immediate cash flow or earnings. Since the mid 1980s, low and uncertain oil prices have reduced upstream cash flow and delayed major project construction. Combined with lower than anticipated downstream returns, these factors have left Petro-Canada with a short- to medium-term performance gap that management has deemed unacceptable.

Consequently, a major overhaul of Petro-Canada is underway. Although operating strategies remain broadly consistent, we are radically altering the Corporation's cost structure, asset balance, operating practices and organization. The objective is to build a profitable bridge to the future, since we recognize that business conditions are likely to remain far different from the more buoyant ones under which past investments were made.

This report begins with a discussion in the Feature Article of Petro-Canada's strategic response to a range of external and internal business challenges. It points out that while Petro-Canada's challenges are not unique, they are more acute than those facing its major competitors. The divisional reports and the Financial Review cover specific actions undertaken or planned and their implications. These include reducing costs, tightening capital spending criteria, selling assets, and pursuing appropriate new business opportunities within the petroleum sector.

The far-reaching changes to the Corporation and its operations resulted in an extraordinary 1989 charge of $54 million after tax. Implementation of the various change programs will continue throughout much of 1990. It is anticipated that the benefits from these programs will begin to influence key financial indicators by year-end 1990.

We will be judged by our performance



A significant achievement in 1989 was the reduction in overhead; additional cost control efforts are continuing in 1990. The total staff complement was reduced by 905 to 6 468 at year-end 1989, far below the high for the Corporation of 9 747 in 1985. Much of our organization has been re-aligned to enhance its ability to operate the restructured businesses. New organizational groupings have been established to develop, implement and be accountable for business strategies in specific areas.

In diversifying its asset base, the Corporation pursued initiatives that were attractive for their strategic fit. Most prominent were the recent agreements to acquire the ICG propane business and build an MTBE manufacturing facility.

Many of Petro-Canada's existing strategies were refocused during 1989 to support the Corporation's drive for higher profitability and growth. In the upstream, we are striving to expand the natural gas business, optimize Western Canada oil operations, and add crude oil reserves and production from new sources in the Canadian frontiers and internationally. In the downstream, more is being done to focus operations on the customer, improve revenue generation from existing assets, increase the efficiency of refineries and build a stronger lubricants business.

Petro-Canada endeavours to manage its financial affairs conservatively. We welcome the February 1990 announcement by the Government of Canada to offer the shares of Petro-Canada to the Canadian public. Preparations are underway within the Corporation to launch the initial offering. This new equity will give Petro-Canada additional financial strength and the flexibility to finance its growth, particularly in energy development projects, without an imprudent increase in debt.

I am certain that 1990 will be a turning point in the Corporation's history. By the early 1990s, Petro-Canada's financial results will reveal the full benefits of the developments that have been initiated.

During the past year, changes in personnel and reporting relationships left many people in Petro-Canada with extra workloads. Others left the Company as a result of downsizing efforts. We recognize the contributions that all have made. We are also gratified that the Minister of State for Privatization, in his February 21 speech to the House of Commons, acknowledged the valuable role of employees in the unfolding of Petro-Canada's bright future.

W.H. Hopper
Chairman of the Board
and Chief Executive Officer

March 23, 1990

Making a new path for the 1990s

Over the last 16 years, oil and gas companies in Canada have seen unparalleled change in factors affecting their operations. Petro-Canada has weathered more change than most, and has lagged its competitors in financial performance. The challenge it is now assuming is to become an industry leader in the 1990s.

President and Chief Operating Officer
Ed Lakusta

This article discusses the changes that have influenced the petroleum industry in Canada and Petro-Canada's response to these new conditions.

Oil and gas prices have been unpredictable

Perhaps the most important single factor underlying the current restructuring of the oil and gas industry is the price of oil. The fluctuations over the last 16 years would be hard to match in any other Canadian industry dependent on one commodity and its price performance.

After being low and reasonably stable for years, oil prices rose so rapidly in the 1970s that it was widely believed they would continue to increase indefinitely. This was not to be the case. Most observers now believe the industry faces a new business reality, with oil prices continuing to fluctuate over the long term.

Developments in the price of natural gas have been similar. Gas prices have eroded considerably in recent years, to the point where they are well below replacement costs from exploration.

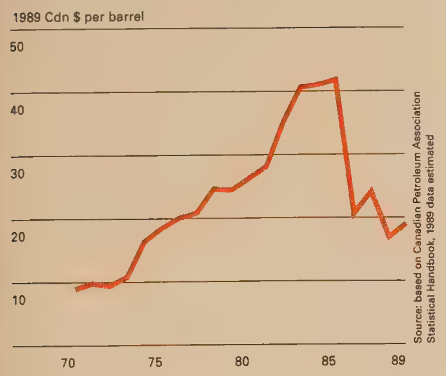
Lower gas prices have been caused by the decline in crude prices and the deregulation of the North American natural gas industry at a time of surplus supplies. However, the price outlook for gas is brighter than for oil. Prices are expected to rise as excess supplies are absorbed and as demand increases. Gas is also viewed as an environmentally superior fuel to oil. Nonetheless, it will be some time before natural gas prices approach the levels of the early 1980s.

Energy policy has shifted markedly

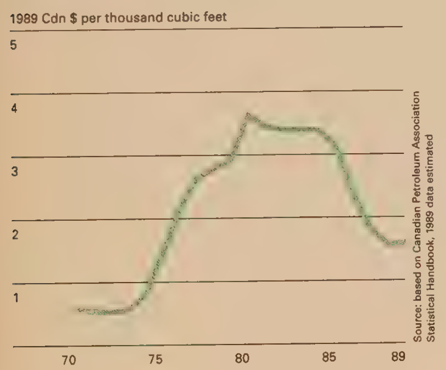
There have been dramatic changes in Canadian energy policy as well. Prior to the mid 1980s, the Canadian energy industry was highly regulated. "Made in Canada" oil and natural gas prices were determined by negotiations between the federal government and the producing provinces. The National Energy Program of 1980 imposed additional taxes and levies, encouraged exploration in areas which would otherwise have been uneconomic, and stringently controlled exports.

In the mid 1980s, the signing of the Western Accord and the Natural Gas Pricing and Marketing Agreement began a new trend of deregulation that has been welcomed by the industry. Oil and natural gas prices in Canada are now largely driven by supply and demand. Increasingly, the location of exploration activity and selection of markets is determined by private-sector economics. The 1989 Free Trade Agreement reinforces these developments.

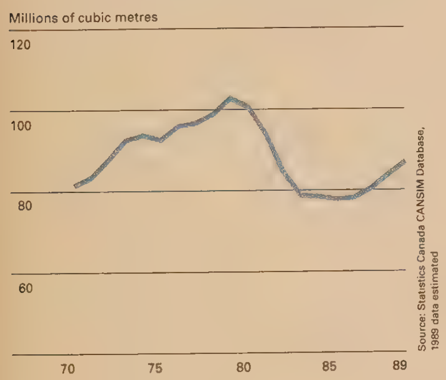
Canadian crude oil price
(Average wellhead price)



Canadian natural gas price
(Average plant gate)



Canadian refined petroleum products sales



Supply and demand movements have reshaped industry

There is an increasing consensus that the Western Canada Sedimentary Basin has matured as a source for conventional light crude. Many producing fields are in decline and new fields are expected to be smaller and involve higher finding costs. Operating costs are rising because of the growing need to apply expensive recovery schemes to depleting reservoirs. As a result of these factors, Western Canadian conventional light crudes are satisfying a decreasing portion of Canadian demand.

In the downstream, the Canadian demand for refined petroleum products shrank by about 24 per cent between 1979 and 1985, and still remains about 16 per cent below the peak level of the late 1970s. There have also been significant changes in the demand mix in favour of lighter, higher octane and cleaner products.

Demand shifts have resulted in surplus and inappropriate refining capacity, forcing refiners to rebalance their crude slates and reconfigure their refineries. In addition, marketers have had to rationalize older, established retail and wholesale networks and update facilities and products. The growth of regional independent marketers has intensified competition. This situation has depressed downstream returns throughout much of the 1980s.

The environment is a critical challenge

Growing public and government concern has produced exceptionally rapid growth in the priority given to environmental protection. In the early years of the decade, environmental regulation focused around new project approval in the upstream. More recently the context has become broader and the entire industry has come under scrutiny. Attention has been directed with particular intensity to refinery effluents, tank leakages, and carbon dioxide and lead emissions.

The economic impact of recent trends is that the cost of remaining in business is growing as environmentally related capital expenditures become increasingly significant. These expenditures could reduce profits in the medium term but will provide competitive advantage to those companies that have paid ongoing attention to environmental concerns and can respond quickly and effectively to the challenge.

Industry performance has been discouraging

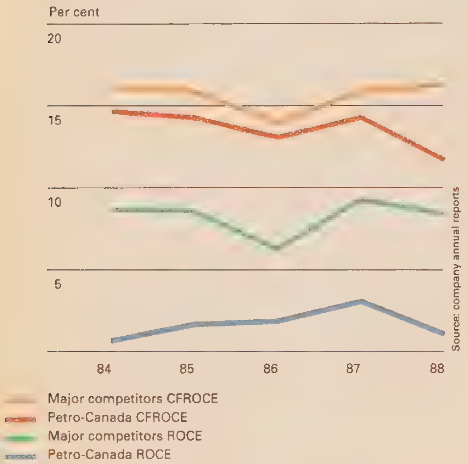
The Canadian oil and gas industry has been hurt by the many changes it has faced. While the petroleum industry in Canada typically earned higher returns than other non-financial industries in the 1970s, the reverse has been true since the early 1980s.

Petro-Canada's results have been unsatisfactory

Petro-Canada has had to deal with the same, changing business conditions that have confronted the industry as a whole. However, two unique circumstances have also influenced the Corporation's financial performance. Until 1984, Petro-Canada

Return on capital employed — petroleum versus other non-financial industries

Return on capital employed and cash flow return on capital employed — Petro-Canada versus its major competitors*



*Average of national integrated competitors
All data reflect successfull efforts accounting

operated under a mandate that combined commercial goals with public policy objectives of the federal government. The Company's focus was on making a contribution to national energy policy objectives, such as security of supply, rather than on profitability. Although Petro-Canada has operated as a commercial entity in recent years, the legacy of the earlier mandate continued to be reflected in the Corporation's financial performance indicators.

Petro-Canada is also unique because it grew rapidly through acquisitions in both the upstream and downstream segments of the industry, and in an era of high energy prices and industry optimism. Such growth led to a high-cost asset base relative to its major competitors, and considerable effort and expense integrating the operations, systems and cultures of the various predecessor companies.

As a result of these factors, Petro-Canada has not performed well relative to its competitors. In the last several years, earnings have been squeezed by declining revenues and rising operating and overhead costs.

Petro-Canada's response is far reaching

Petro-Canada recognizes that, to be a leader in the Canadian oil and gas industry, it has to gain control of its future. The Corporation must position itself to withstand sustained periods of low crude prices and take advantage of opportunities in more buoyant periods.

A new vision

Petro-Canada began preparations for the 1990s with the development of a new vision which sets the fundamental objectives for the Corporation. The emphasis is clearly on profitability and future growth, that is, the creation of shareholder value.

Recognizing that a ''business as usual'' operating mode could not lead to progress toward the vision, management initiated a number of important change programs in 1989.

Strategies have been adjusted

Petro-Canada began, and largely completed, comprehensive strategic reviews of its entire upstream and downstream businesses. The reviews involved the reconfirmation or adaptation of earlier strategies to recognize changed business conditions and support the vision. These strategies are discussed in detail in the Products and Resources chapters of this report. Concepts underlying this rethinking included a reduced reliance on upswings in crude prices to produce healthy returns and more concentrated core operations in areas of sustainable competitive advantage.

Asset rationalization has begun

Both strategic reviews have emphasized the identification of underperforming and low-potential assets so that the Corporation can rationalize its asset base. Significant divestitures are planned over the next several years, with over half from the upstream. Close to $120 million of sales have already been concluded.

The Vision

"As Canada's petroleum energy company, Petro-Canada is a dynamic and profitable leader, diversified in those elements of the integrated petroleum industry which have high potential for profitability and future growth. We are a unique Canadian corporation and are commercially responsive to the expectations of Canadians for leadership in products, services and standards of operations. We operate internationally to enhance the value of the Corporation."

Asset divestitures will lead to a short-term loss of associated margins. However, the long-term benefits will be the correction of underperformance problems and more focused operations. Improved competitive position and enhanced financial performance will follow.

Diversification is underway

Diversification is an increasingly important element of overall corporate strategy at Petro-Canada. Until recently, the Corporation operated primarily in the traditional components of the petroleum "value chain": oil and gas exploration and production, and oil refining and marketing. Participation in other components can contribute to higher profitability and growth through synergies with existing businesses and reduced exposure to business risks associated with oil prices. The Corporation is examining opportunities in several attractive subsectors of the petroleum industry. The recent agreements to acquire the ICG propane business and construct an MTBE plant, described elsewhere in this report, are examples of how Petro-Canada is approaching diversification.

Cost reduction has been dramatic

The Corporation has developed more cost-effective ways of managing existing businesses and support services. Changes include eliminating non-essential work and duplication, reducing organizational layers, broadening spans of control, streamlining management processes and decentralizing support services. With a 12 per cent reduction in staff, major realignments are underway in all parts of the organization and most are nearing completion.

Administrative and operating costs will be down $170 million in 1990, or about 9 per cent, from the levels that would have been reached in the absence of these changes. Additional cost reductions are planned in the future. The conversion to the successful efforts method of accounting in 1989 has assisted in sharpening exploration expenditure decisions by emphasizing their immediate effect on "bottom line" results.

Performance must improve

Petro-Canada's response to today's business context is comprehensive and ambitious. It needs to be in order to realize the Corporation's target of becoming a leading national competitor in the Canadian petroleum industry by 1994 or earlier. With the strategies and change programs in place at the end of 1989, Petro-Canada considers this target challenging, yet realistic.

The Resources division's 1989 results were low, but significantly better than in 1988. Earnings of $80 million were up from a loss of $89 million, while working capital provided from operations was unchanged at $379 million. The cash flow return on capital employed was 13.7 per cent and the return on capital employed was 3.1 per cent. Continued improvements are expected as a result of change programs initiated over the past year.

Resources President Jim Stanford (centre) with (left to right) Senior Vice-Presidents Jim Pantelidis (Resource Development and Production) and Peter Kaye (Exploration)

The 1989 earnings improvement came from several factors. Higher crude prices, partially offset by lower production volumes, contributed $92 million to revenues. Prices, based on the West Texas Intermediate benchmark crude, averaged U.S. $19.45 per barrel, $3.49 higher than in 1988. Production of crude oil and natural gas liquids declined 4.6 per cent to 100 400 barrels per day. Near record production was reached at the Syncrude oil sands facility.

Natural gas production reached an all-time high at 571 million cubic feet per day, up 17 per cent over the previous year. Lower natural gas prices limited the net benefit to $19 million. A three cent increase in the value of the Canadian over the U.S. dollar reduced revenues by $22 million. Gains on asset sales, countered by increased expenses, contributed $14 million to earnings. The remaining increase in pretax earnings of $155 million came from lower exploration expense and reduced depreciation, depletion and amortization charges. In 1988, carrying values of certain oil and gas assets were written down to fair market value under

Financial	**1989**	1988
Revenue (millions of dollars)	**1 142**	989
Earnings (loss) (millions of dollars)	**80**	(89)
Working capital provided from operations (millions of dollars)	**379**	379
Expenditures on property, plant and equipment and exploration (millions of dollars)	**334**	611
Average capital employed (millions of dollars)	**2 601**	2 610
Cash flow return on capital employed (per cent)	**13.7**	14.4
Return on capital employed (per cent)	**3.1**	(3.4)

Operating	**1989**	1988
Crude oil and field natural gas liquids production, net before royalties (thousands of barrels per day)		
Conventional crude oil and field natural gas liquids	**75**	79
Synthetic crude oil	**25**	26
Total	**100**	105
Natural gas production, net before royalties (millions of cubic feet per day)	**571**	488
Proved reserves of crude oil and natural gas liquids, net before royalties (millions of barrels)	**527**	582
Proved reserves of natural gas, net before royalties (billions of cubic feet)	**3 340**	3 474

Repositioning for higher profitability

Resources profile

On a typical day, Petro-Canada produces approximately 100 000 barrels of crude oil and field natural gas liquids, and 571 million cubic feet of natural gas. The Corporation's straddle plants extract an additional 45 000 barrels of natural gas liquids, including ethane, from pipeline natural gas. Petro-Canada accounts for approximately 5 per cent of domestic oil and natural gas liquids production and close to 6 per cent of domestic natural gas production. The Corporation operates more than 70 oil and gas production facilities in Western Canada.

At year-end 1989, Petro-Canada had proved reserves of crude oil and field natural gas liquids of 527 million barrels before royalties. Proved reserves of natural gas amounted to 3.3 trillion cubic feet before royalties.

Petro-Canada also has significant probable and potential reserves off Canada's East Coast and in the oil sands areas of Alberta.

The Corporation holds interests in 11 crude oil, natural gas liquids and refined products pipelines.

Western Canada value centres

Value centres	● Main oil reserves and production locations	■ Main natural gas reserves and production locations
British Columbia	1 Boundary Lake	1 Yoyo
Northern Alberta	2 Valhalla	2 Clarke Lake
Whitecourt	3 Utikuma	3 Laprise
West Pembina/ Alberta Foothills	4 Nipisi	4 Grassy
Conventional heavy oil	5 Swan Hills	5 Jedney
Eastern Alberta/ Saskatchewan	6 Brazeau	6 Kobes Creek
	7 Pembina	7 Kaybob South
	8 Bellshill Lake	8 Windfall
	9 Kinsella	9 Whitecourt
	10 Wainwright	10 Hanlan
	11 Provost	11 Brazeau
	12 Cactus Lake	12 Gilby
		13 Cow Lake
		14 Ricinus
		15 Alderson
		16 Medicine Hat
		17 Hatton

Business conditions

Crude oil prices

- November 1989 OPEC accord increased daily production target to 22.1 million barrels
- January 1990 actual production dropped to within 1 million barrels of the target
- January prices rose to U.S. $23.70(WTI), up $4.45 since the accord
- Petro-Canada expects continuing volatility with prices in 1990 averaging near 1989 levels

Natural gas prices

- average B.C. plant gate prices were much weaker than in 1988, averaging $1.36 per thousand cubic feet over the year and slipping to $1.28 by year end
- average Alberta plant gate prices, $1.61 per thousand cubic feet, were slightly below very low 1988 levels; the last quarter 1989 price recovered to $1.70
- export demand will grow, but the timing of price increases remains uncertain

Canadian/U.S. dollar exchange rates

- 1989 exchange rates averaged U.S. 84 cents, compared to 81 cents in 1988 and 75 cents in 1987
- early 1990 rates reached U.S. 87 cents, then dropped to 83 cents in February
- rates will continue to be affected by fiscal and monetary policy and international financial markets

the application of the ceiling test. In 1989, the influence of the ceiling test was less significant. The above factors generated an overall increase in pretax earnings of $258 million. After providing for associated income taxes, the increase in net earnings was $169 million.

Proved reserves of natural gas slipped 4 per cent from 1988 to 3.3 trillion cubic feet and proved reserves of crude oil and natural gas liquids declined 9 per cent to 527 million barrels. Part of this decline was attributed to the reclassification of reserves associated with the Wolf Lake in situ project as well as the impact of the asset disposition program. Some encouraging discoveries were made in natural gas. However, prospects for sizeable oil exploration successes in Western Canada are dwindling and production is declining rapidly at many conventional oilfields.

Comprehensive changes were begun in 1989 to improve immediate financial results and medium-term prospects for the upstream business. The division altered its organization, particularly with respect to conventional operations in Western Canada, and initiated a process to improve the quality of its asset base.

Changed approach to business

To respond to the higher finding and operating costs that result from the maturity of the Western Canada Sedimentary Basin, the division has developed a new operating framework. Future success will depend on increasing the efficiency of existing operations, while focusing new exploration and development capital on the most promising opportunities. To this end, the division has divided its Western Canada asset base into value centres. Properties that are not of strategic significance are candidates for divestiture and potential acquisition opportunities are being studied.

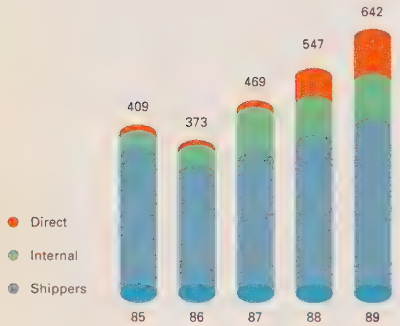
The restructuring encourages a ''small business'' operating style with closer integration of exploration, development, production and marketing skills, and control of overhead costs and support functions. The organization is designed to ensure that every employee has a more direct involvement in creating shareholder value. Petro-Canada believes the value centres will establish the foundation for future growth and form a key element in improving performance from the existing asset base.

Consistent with the new operating framework, the division has assigned selected senior explorationists to three stratigraphic exploration groups. The aim of these specialized groups is to establish exploration plays that can contribute profitably to an existing or new value centre.

A program carefully designed to encourage continuous improvement in business performance was begun in 1989, and will be enhanced by the value centre organization. Already, individual employees are improving operating results through hundreds of small-scale changes, in areas from electrical power and chemical costs to compressor operating efficiency.

Natural gas reserves
(billions of cubic feet)

Natural gas production
(millions of cubic feet per day)



Natural gas sales
(millions of cubic feet per day)

Focusing the asset portfolio

Petro-Canada is reducing its upstream asset portfolio to improve financial performance under current and anticipated business conditions. Having built up an excellent position in the country's longer-term frontier and oil sands resources in its early years, Petro-Canada now has a large proportion of its upstream assets concentrated in high-cost sources of future supply. By the early 1990s, careful and selective programs of divestitures, swaps and acquisitions will lead to a more appropriate mix of short- and long-term sources of cash flow.

The division is also concentrating ownership in fewer oil and gas properties in order to take advantage of operator or leading partner status. This positioning allows Petro-Canada to reduce administrative costs and be more effective in a deregulated business.

Resources division asset divestitures reached $97 million in 1989. Approximately $85 million of these proceeds came from the sale of working interests in conventional Western Canadian producing properties that are, for the most part, operated by partners. By year end, Petro-Canada had sold its working interests in 19 properties in Alberta and Saskatchewan, most of them related to oil, its interests in the small Cohasset and Panuke oilfields off the coast of Nova Scotia, and its seismic vessel, the Bernier.

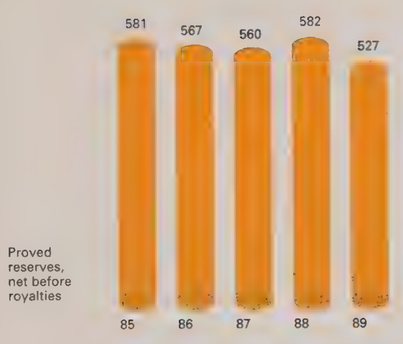
Asset restructuring in 1989 also took the form of swaps and selective acquisitions. In mid year, Petro-Canada concluded a swap with a partner involving minor working interests in a total of 34 Western Canada properties. Assets acquired during the year included additional working interests in the Clarke Lake gasfield in northeastern British Columbia and in the Casablanca oilfield offshore Spain. At Clarke Lake, the $15 million acquisition of 32 billion cubic feet of proved reserves enabled Petro-Canada to increase ownership of this strategically important field.

Gaining strength in natural gas

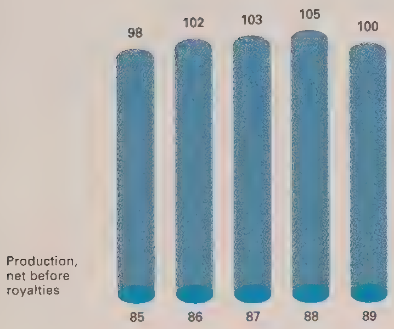
Petro-Canada's natural gas strategy is based on the assumption that U.S. reserves will be insufficient to meet that country's growing gas requirements, and that demand will increase as the environmental advantages of gas become more important. Consequently, the anticipated rise in demand and prices for Canadian gas make investments in reserve additions, transportation and marketing attractive.

In 1989, natural gas exploration accounted for 76 per cent of total capital spending on Western Canada exploration. This percentage is expected to increase in 1990. During the year, exploration and development in Western Canada added 29 billion cubic feet to the Corporation's proved natural gas reserves.

It was an exceptional year for natural gas marketing. Total sales reached a record level of 642 million cubic feet per day, up 17 per cent from 1988. This amount comprised shipper sales, and direct sales to internal and external end users. Sales rose in all three categories. Volumes sold directly to end users climbed 59 per cent over 1988, to 110 million cubic feet per day. Customers included major gas distributors in Eastern Canada and the U.S. Northwest, Eastern Canada residential and commercial markets and Alberta and B.C. industrial consumers.



Crude oil and natural gas liquids reserves
(millions of barrels)



Crude oil and field natural gas liquids production
(thousands of barrels per day)

During the year, Petro-Canada pursued an attractive opportunity to deliver its natural gas to southern California markets. The Corporation is a 16.7 per cent participant in the Altamont Gas Transportation Project, which proposes to construct in the mid 1990s a 30-inch, 700 million cubic feet per day pipeline from Wild Horse, Alberta, to Opal, Wyoming. Project sponsors estimate the total cost of the 620-mile pipeline to be U.S. $580 million. At year end, participants were awaiting key decisions from California regulators and had completed and filed an environmental report with U.S. federal regulators. In February 1990, Petro-Canada concluded a transportation agreement for 120 million cubic feet per day with Kern River Gas Transmission Company. Gas from British Columbia will be transported through Northwest Pipeline Corporation into the Kern River pipeline.

Expansion of the Petro-Canada-operated Brazeau sour gas plant in west-central Alberta was completed in December, on schedule and under budget, at a cost to the Corporation of $21 million. Petro-Canada's interest in the expanded plant is 36 per cent. The expansion has significantly boosted plant production of natural gas liquids and sulphur.

Optimizing Western Canada conventional oil operations

Work was completed on the third phase of an infill drilling program at the Petro-Canada-operated Valhalla oilfield in northwestern Alberta. During 1989, the addition of nine producing and three injection wells increased production by 1 000 barrels per day.

A major infill drilling project was completed early in the year at the Petro-Canada-operated Provost conventional heavy oilfield in east-central Alberta. With an additional 30 wells in operation, production climbed from 800 to 2 500 barrels per day.

During the year, the Resources division began a five-year program to systematically review all non-producing wells in Western Canada. Some of these wells will be returned to production, while others will be abandoned. Coordination with regulatory bodies will ensure that the Corporation's techniques for abandonment and suspension meet new industry standards.

Developing sources of crude oil for the future

Petro-Canada continued in 1989 its quest for new sources of crude oil from the East Coast offshore, the Alberta oil sands and from international operations.

The Corporation's work on the Terra Nova offshore oilfield has been encouraging. Recent geological mapping and analysis of well test data led to a revision of the probable reserves estimate for the field from 132 to 300 million barrels. The Corporation is the operator and currently holds a 44 per cent interest in the Terra Nova consortium. At year end, Petro-Canada and its partners were finalizing reviews of reserves and production facility systems prior to deciding upon the

submission of a development application. The project, envisioned to cost in excess of $2 billion before production commences, is expected to produce 75 000 barrels per day. Under favourable circumstances, construction could begin prior to the mid 1990s.

The Hibernia consortium, of which Petro-Canada is a 25 per cent participant, undertook further pre-development engineering for the 110 000 barrels per day project. The consortium re-examined the design of the topside production facilities, lowering pre-production cost estimates to $5.1 billion. Fiscal negotiations continued between the consortium and the federal and provincial governments. It is anticipated that all agreements will be signed by the middle of 1990, with detailed engineering and construction to follow thereafter.

In February 1990, the federal government announced its intention to withdraw financial support for the OSLO oil sands mining project, in which Petro-Canada holds a 15 per cent interest. The proposed $4.2-billion project would produce 77 000 barrels per day of synthetic crude oil. Work on preliminary engineering design and cost estimates will be finished by July 1991. At that time, a decision will be made on whether to proceed with detailed engineering and construction.

During 1989, the Syncrude oil sands project completed its first year of operations following the commissioning of additional capacity. Production was 148 000 barrels per day, of which Petro-Canada's share was 17 per cent. A fire in December reduced total plant output to 116 000 barrels per day for the month and held annual production slightly below last year's record. Full production of 165 000 barrels per day should resume by the end of the first quarter, 1990.

At the Wolf Lake in situ project an expansion was completed during 1989. However, the additional capacity was not brought on stream because of weak bitumen prices and the announced intention by the operator to sell its 50 per cent interest.

Petro-Canada increased the scale of its international exploration program in 1989 to pursue significant, though higher-risk, opportunities for large oil discoveries with relatively low finding and production costs. Fourteen per cent of its upstream capital expenditures supported exploration initiatives in South America, South East Asia and the Middle East. Petro-Canada reported oil discoveries at two wells in the Middle Magdalena Valley in Colombia, and in the Oriente region of Ecuador. One of the Colombian discoveries, in which Petro-Canada has a 50 per cent interest, is considered significant enough to merit immediate development. At the close of 1989, Petro-Canada added 1.7 million barrels of proved and 7.3 million barrels of probable oil reserves as a result of the Colombia and Ecuador successes and the increased working interest in the Casablanca field in Spain.

Petro-Canada pursued two major diversification initiatives in 1989: an agreement to acquire the retail propane business of Inter-City Gas Corporation and a decision to build a plant to make MTBE, an octane-boosting gasoline component.

(Left to right) Vice-Presidents Tom Simms (Integration) and Brant Sangster (Corporate Development)

Both projects will extend Petro-Canada's base businesses into related areas where the Corporation has not been well represented. In both cases, anticipated rates of return will raise overall profitability levels. The two projects will help stabilize Petro-Canada's earnings because their profitability will be affected by different factors than those influencing core operations.

The Corporation is in the process of acquiring the retail propane business of Inter-City Gas Corporation. The purchase, which was negotiated in 1989 at a price of $265 million plus an earnings adjustment, is expected to be concluded near the end of the first quarter of 1990.

Petro-Canada will operate the new business as ICG Propane Inc., a wholly owned subsidiary of Petro-Canada Inc. To take advantage of its established value, the ICG brand and logo will be retained. The principal benefit of the acquisition will be a balanced presence in all segments of the propane business.

Petro-Canada has a 50 per cent initial interest in the construction of Canada's first MTBE plant. Methyl tertiary butyl ether (MTBE) is a high-value product that can be blended into gasoline to boost octane without the detrimental effects of lead. The Corporation's joint venture partner is Neste Oy, the Finnish state oil company. The facility, with an estimated total construction cost of $350 million, will be located in Edmonton, Alberta, close to sources of the two major raw materials, butane and methanol. In addition to supplying the plant with butane, Petro-Canada can market up to half of the production. Following regulatory approvals, project construction will begin in the spring of 1990.

To Petro-Canada, the project is an attractive diversification opportunity for several reasons. The profitability of an MTBE venture will be less subject to the crude oil price swings that affect the Corporation's base businesses. Due to the ongoing weakness of the wholesale butane market, the project will help Petro-Canada earn greater value from its substantial butane production. Furthermore, the MTBE proposal addresses the powerful call for environmentally friendly fuels. Under the U.S./Canada Free Trade Agreement, there is growing export potential for MTBE, particularly in U.S. states that have strict environmental controls.

Results for the Products division in 1989 were below expectations. Earnings were essentially level at $104 million, producing a return on capital employed of 3.9 per cent. Cash flow return on capital employed was 8.8 per cent. During the year, management began to implement far-reaching programs aimed at performance improvements.

Products President Barry Stewart (front) with Senior Vice-Presidents (left to right) Ford Ralph (Central Region), Gaston Beauregard (Eastern Region) and Norm McIntyre (Western Region)

Total revenue of $4 442 million increased $197 million, or 4.6 per cent, from the previous year. Of this increase, $135 million was attributable to petroleum product revenues. Sales volumes, which were just over 1 per cent higher than 1988, were combined with price increases of 2 per cent. The remaining $62 million was primarily due to an increase in non-petroleum revenue from car washes, Certigard, and tires, batteries and accessories.

Operating earnings were virtually unchanged at $339 million. Revenue increases were offset by crude costs that were up $135 million, or 6.5 per cent from the previous year, increased marketing expenses from the reidentification to ''Maximum'' products, and environmental expenses. Operating earnings per litre of sales remained virtually unchanged at 2.09 cents.

Working capital provided from operations decreased to $237 million from $299 million due mainly to higher current income taxes allocated to the division.

To some extent, the division's weak performance can be attributed to industry-wide business fundamentals that remain far from optimal. Industry product demand rose about 4 per cent over the year, but it did so amidst persistent competition. In addition, major environmental initiatives placed high demands on capital and operating expenses.

Not satisfied with the year's financial results, management has embarked on a radical reworking of the way the division does business. The objective is a marked improvement in profitability levels, regardless of industry trends.

Financial	**1989**	1988
Revenue (millions of dollars)	**4 442**	4 245
Earnings (millions of dollars)	**104**	102
Working capital provided from operations (millions of dollars)	**237**	299
Expenditures on property, plant and equipment (millions of dollars)	**208**	159
Average capital employed (millions of dollars)	**2 697**	2 700
Cash flow return on capital employed (per cent)	**8.8**	11.3
Return on capital employed (per cent)	**3.9**	3.8

Operating	**1989**	1988
Petroleum products sales (thousands of cubic metres per day)	**44.4**	43.8
Retail outlets at year end	**3 295**	3 429
Refinery crude capacity at year end (thousands of cubic metres per day)	**54.2**	60.6
Crude oil processed by Petro-Canada (thousands of cubic metres per day)	**46.5**	48.5
Average refinery utilization (per cent)	**86**	77

Streamlining operations around customers

Business conditions

Refined products outlook

- prices mainly influenced by crude costs, import prices for refined products and industry competition
- a downturn in the economy will likely slow growth in product demand

Competition

- a merger has reduced Petro-Canada's national, integrated competitors from three to two
- competition continues from regional refiner/marketers and independent retailers
- rising operating costs, increases in crude costs and pressure on prices are continuing to restrain margins

Refining

- surplus refinery capacity has been shrinking and efficiency improving due to rationalization, gradual increase in demand, environmental regulations and reconfigurations to meet new product requirements

Environment

- capital investments needed to meet environmental regulations are expected to increase

Products profile

Petro-Canada refines crude oil, markets a full range of petroleum products, including fuels and lubricants, and provides automotive maintenance products and services.

The Corporation sells over 44 million litres of refined products each day and holds approximately 19 per cent of Canada's retail gasoline market. Petro-Canada's countrywide retail network has 3 295 outlets. Industrial and commercial customers are served through 35 terminals and 372 bulk plants.

Petro-Canada operates four refineries, including a lubricants plant and a secondary processing facility, in Quebec, Ontario, Alberta and British Columbia. With about 18 per cent of total Canadian refining capacity, these facilities process up to 46 500 cubic metres of crude oil per day.

Reducing costs

A major operating cost reduction program was launched in 1989, and will be fully implemented in 1990. Savings will be achieved through lower marketing expenses, facility rationalization, decreased Company control of retail facilities and increased franchising. In addition, corporate-wide cost cuts and the decentralization of support services will give the division better control of overhead expenses. Beyond these measures, the planned restructuring of assets will result in a streamlined, lower-cost organization.

Restructuring assets

During 1989, the division launched a strategic review to examine the performance, contribution and potential of all downstream components. The review will also address efficiency questions that continue to arise in relation to the diverse assets acquired from four predecessor companies. Those parts of the business that do not support the drive toward improved profitability will be divested. The resulting asset base, focused on more closely integrated refining, marketing and supply strengths, will result in lower levels of capital employed. Implementation of recommendations will follow the scheduled completion of the review in early 1990.

Divestitures in 1989 amounted to $21 million, and included the Moose Jaw asphalt plant and the associated Stoney Beach pipeline.

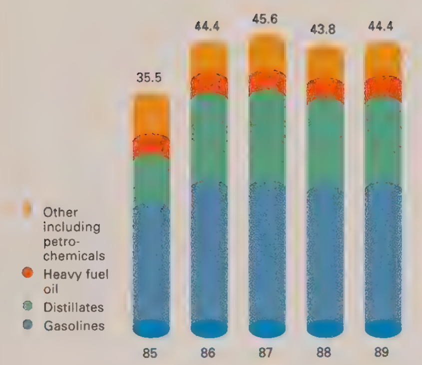
During 1989, Petro-Canada acquired a 49 per cent interest in Jiffy Lube Canada Inc., a chain of fast-lube franchises. The acquisition gave Petro-Canada an outlet for its lubricants and automotive accessories, and equity participation in the rapidly growing Canadian fast-lube market.

Reorganizing around the customer

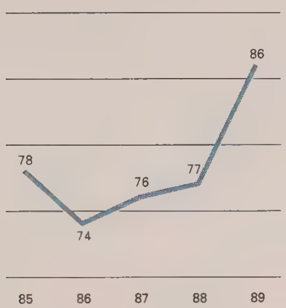
Underlying the division's improvement programs is the principle that profitability cannot be raised without satisfied customers. Early in the year, a task force completed its analysis of consumer reactions to Petro-Canada's products and services. It found there was a strong opportunity to gain more secure product demand by returning to the basics – understanding customers and providing for their needs.

A revised organizational structure and new operating philosophy have been developed and implemented. The division has been streamlined and decentralized, sharpening the focus on customers. Local managers now have greater accountability for profits and more control over their operations, such as in pricing and business development.

Petro-Canada has been actively developing business associates at the field level since 1988 through the wholesale marketer program. To compete more effectively, wholesale operations are being transformed into locally operated businesses. Associates are trained in key areas of management and given increased authority and support. The program combines the best elements of small business and national, integrated operations to improve profitability and enhance the value



Petroleum products sales
(thousands of cubic metres per day)



Average refinery utilization
(per cent)

of the Petro-Canada brand. The Corporation retains ownership of facilities and inventories, providing the consistency, quality and reputation of a national brand. Associates use their knowledge of local markets and the flexibility and speed of local control to respond to specific customer desires. Twenty-seven wholesale marketer businesses had been established by year end.

Increasing revenue from existing assets

During 1989, Petro-Canada continued with the rollout of its Certigard vehicle maintenance and repair program. By December, there were 129 Certigard franchises at key retail sites across the country. Automotive repair revenues were up about 20 per cent on average over pre-franchise sales levels, and a random survey indicated high customer loyalty and good prospects for return business. The Certigard program provides the Corporation with a strong position in a growing market segment.

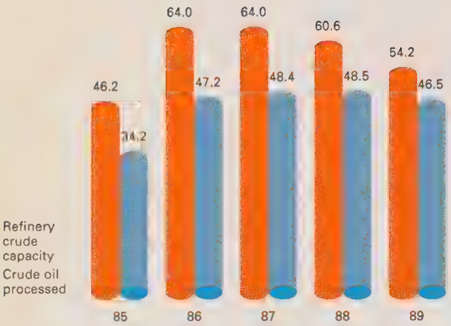
Petro-Canada continues to upgrade its tunnel car wash network, the largest in the country with about one-third of the nation's tunnel wash units and volume. With close to one-quarter of Canada's urban retail gasoline demand associated with car washes, the division's upgrading program is aimed at promoting higher gasoline sales and greater car wash revenue.

Refining more efficiently

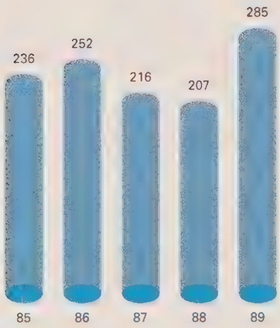
Refinery utilization increased from 77 to 86 per cent, the result of stronger product demand, the sale of the Moose Jaw asphalt plant and, most significantly, the integration of refinery operations. The integrated Port Moody and Edmonton facilities have operated smoothly for well over a year. The former Trafalgar and Clarkson refineries have been brought under single management, and renamed the Oakville and Mississauga plants of the Lake Ontario refinery. Unfinished streams are transferred for secondary processing in the more efficient units at each plant, allowing a secondary unit at Oakville to be shut down.

Petro-Canada continues to reduce production costs and improve the reliability of its refineries through capital projects and improved operating and maintenance procedures. Ongoing reinstrumentation and computerization projects are well advanced, with work completed at Edmonton and the first phases at Montreal and Lake Ontario Oakville scheduled for completion in 1990.

Petro-Canada's refineries are well configured to respond to the declining supplies of domestic light sweet crude and the worldwide trend to heavier feedstocks. The refineries have an above average ability to process heavy crude. As Canada's leading supplier of asphalt, a heavy crude derivative, the Corporation stands to benefit from the widening spread between light and heavy crude prices. The Lake Ontario lubricants plant has the capability to turn even marginal crudes into high quality lubricating oils and greases. The Edmonton refinery, with units specially designed to process synthetic crude into high-quality transportation fuels, has been handling significant volumes of synthetic crude since 1982. As light sweet crude supplies decline, synthetic crude will become an increasingly attractive feedstock.



Refinery crude capacity*and crude oil processed
(thousands of cubic metres per day)
* At year end



Lubricants sales
(cubic metres per day)

With the start-up of the new $37 million isomerization unit at the Lake Ontario refinery, Petro-Canada stopped producing leaded gasoline in Eastern and Central Canada at year end, 11 months ahead of the legislated deadline. A similar $65 million unit under construction at the Edmonton refinery, on schedule and well under budget, will be operational mid-way through 1990. Petro-Canada will then cease production of leaded gasoline.

In Montreal, a decommissioned refinery site has been restored for sale in 1990. Contaminated soil has been gathered to a restricted area, where research on an economic treatment process is being carried out with the approval of the Quebec Ministry of the Environment.

Building a stronger lubricants business

Petro-Canada continues to develop its lubricants business by capitalizing on the unique attributes of the HydroTreated (HT) base stocks produced at the Lake Ontario refinery. During 1987 and 1988, sales volumes were held back because of the effects of a fire at the manufacturing plant. In 1989, sales rose 38 per cent, with full capacity returned and with increased participation in the export market.

The market for HT lubricants has been broadened through recent work on ''Super Compressor Fluids''. Formulated from HT base oils and a patented anti-oxidant system developed at the Corporation's Sheridan Park research facility, Super Compressor Fluids are superior to mineral oil compressor fluids and equal to the best synthetic products. Field trials have demonstrated that Super Compressor Fluids offer the user appreciable annual savings from longer service life, significantly reduced downtime for maintenance, and greatly reduced power consumption.

A new product launched internationally in 1989 has already gained excellent market penetration because of its environmental performance. ''Purity PDO 2201'' is a defoamer oil created through Petro-Canada's HT process. Designed for use by kraft pulp and paper operations in meeting strict dioxin and furan control regulations, Purity PDO 2201 is unmatched in environmental protection and overall performance by any other defoamer oil. Studies by the Pulp and Paper Research Institute of Canada have shown that most defoamer oils contain impurities that are changed during the bleaching process into carcinogenic dioxins and furans. Purity PDO 2201 contains no carcinogenic impurities above the minimum detectable level of one part per billion.

Petro-Canada has always understood that it is expected to deliver more than good financial results. Canadians believe that socially responsible behaviour should be second nature for their national petroleum corporation.

(Left to right) Vice-Presidents Claude Houde (Corporate Services), Bob Foulkes (Public Affairs) and Bob McCaskill (General Counsel)

In 1989, Petro-Canada developed a new advertising theme, ''Committed to Canadians''. Those words not only form the signature of each commercial, they also encapsulate Petro-Canada's operating philosophy. The purpose of the campaign is to communicate more fully the Corporation's contribution to the country, strengthen its reputation for good corporate citizenship and add value to the Petro-Canada brand.

This expectation means greater challenges for employees as they conduct business, but it also provides ongoing opportunities to reinforce the Corporation's position as a valued and respected member of the Canadian community. Petro-Canada takes corporate responsibility seriously, recognizing its fundamental contribution to financial success.

During 1989, concern about the environment emerged as the leading public issue among Canadians. Petro-Canada was able to respond well to this priority. The Corporation emphasizes environmental protection through a specific environmental policy, environmental audits, comprehensive oil spill and emergency response programs and other initiatives. It has also taken a leadership role with industry organizations, such as the Canadian Petroleum Association and the Canadian Petroleum Products Institute, in developing specific programs to assist the industry-at-large in improving its environmental performance. As well, a retail promotion in association with World Wildlife Fund Canada raised approximately $200 000 for the preservation of Canadian endangered species.

A capital intensive initiative underway in 1989 was the removal of leaded gasoline from many markets, well ahead of government requirements. Other downstream expenditures on the environment totaled $37 million, and included a refinery waste water treatment plant, storage improvements at refineries and terminals, and the replacement of older underground tanks at retail locations. Investments for similar environmental enhancements will increase in 1990.

In the upstream, community consultation is used to ensure local environmental concerns are taken into account. In an area adjacent to a major sour gas processing facility, Petro-Canada brought together community representatives, other companies and government agencies to jointly sponsor a five-year study of the effect of sulphur on soils.

Besides environmental initiatives, Petro-Canada supports many other activities that add to the fabric of the nation. Two of these had a high profile during 1989. The ''Struggle for Democracy'' television series and book, sponsored exclusively by Petro-Canada, was a sophisticated and timely look at a topic of widespread appeal. Since 1987, retail promotions have raised nearly $5 million for aspiring young athletes and coaches through the Olympic Torch Scholarship Fund.

Senior Vice-President Finance and Planning Wesley Twiss (second from left) with (left to right) Chris Smith (Controller), Brant Sangster (Vice-President, Corporate Development) and Harry Roberts (Treasurer)

Change in accounting policy and restatement of shareholder's equity

Effective January 1, 1989, the Corporation retroactively adopted the successful efforts method of accounting for its investment in exploration and development activities. The Corporation had previously followed the full cost method of accounting. Under the successful efforts method, the costs of exploratory wells that are assigned proved reserves are capitalized, while most other exploration costs are charged to earnings as incurred. Under the full cost method, all costs relating to the exploration for oil and gas reserves are capitalized. Petro-Canada believes that the successful efforts method more appropriately reflects the mature nature of its oil and gas operations, which consist of relatively stable reserves and production with exploration focused mainly on oil and gas targets in conventional basins.

The change in accounting method resulted in a reduction in property, plant and equipment and deferred income taxes of $1 859 million and $671 million respectively. Retained earnings were reduced by $1 188 million to a deficit of $1 434 million at January 1, 1989. A contributed surplus of $1 434 million, created upon the surrender of common shares by the Government of Canada, has been offset against this deficit.

Results of operations

Petro-Canada's 1989 revenues totaled $5.0 billion, up 4.5 per cent from the previous year. Earnings before extraordinary item and dividends on redeemable preferred shares increased sharply by $96 million to $85 million.

An extraordinary charge of $54 million relating to the Corporation's reorganization and staff reduction program lowered net earnings to $31 million. This program is expected to reduce ongoing overhead and operating expenses by approximately $170 million from the levels that would otherwise have been reached in 1990. In

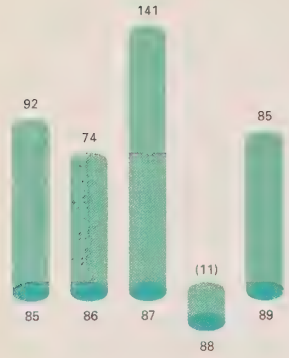
Summary of segmented results

(stated in millions of dollars)

	1989				
	Natural resources	Refining and marketing	Corporate and other	Inter-segment eliminations	Consolidated
Segment revenue	**1 142**	**4 442**	**73**	**(640)**	**5 017**
Earnings (loss) before extraordinary item and dividends on redeemable preferred shares	**80**	**104**	**(99)**	**–**	**85**
Working capital provided from (used in) operations	**379**	**237**	**(47)**	**–**	**569**
Capital and exploration expenditures	**338**	**210**	**(39)**	**–**	**509**
Capital employed	**2 551**	**2 810**	**582**	**–**	**5 943**

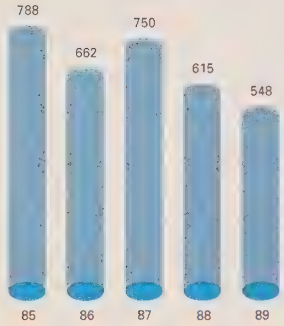
	1988				
	Natural resources	Refining and marketing	Corporate and other	Inter-segment eliminations	Consolidated
Segment revenue	989	4 245	83	(516)	4 801
Earnings (loss) before extraordinary item and dividends on redeemable preferred shares	(89)	102	(24)	–	(11)
Working capital provided from (used in) operations	379	299	(54)	–	624
Capital and exploration expenditures	610	162	97	–	869
Capital employed	2 650	2 585	752	–	5 987

Building a base for higher profitability



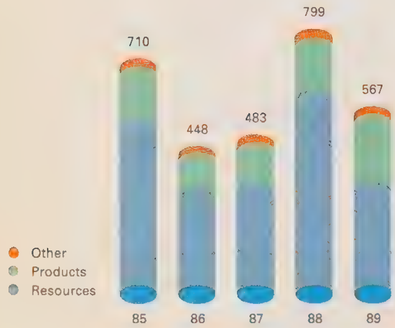
ROCE (per cent)	1.7	1.9	3.1	1.1	3.2

Earnings* and return on capital employed
(millions of dollars)
*Before extraordinary and unusual items and dividends on redeemable preferred shares



CFROCE (per cent)	14.3	13.1	14.3	11.7	11.0

Cash flow and cash flow return on capital employed
(millions of dollars)



Components of expenditures on property, plant and equipment and exploration
(millions of dollars)

the previous year, the Corporation recorded a net loss of $43 million after an extraordinary write-down of $22 million in the carrying value of the investment in Sedpex Inc., and $10 million of dividends on preferred shares redeemed that year.

The improvement in consolidated results came from the Resources division, where $103 million was generated mainly by higher oil prices and greater natural gas volumes, despite lower crude oil production and slightly lower natural gas prices. Substantially reduced exploration, depreciation, depletion and amortization charges contributed $155 million. The reduction in these charges was attributable to the 1988 write-down in the value of certain oil and gas properties under the Corporation's successful efforts based ceiling test. Overall, pretax segment earnings were up by $258 million. On an after-tax basis, earnings from natural resource operations improved by $169 million to $80 million.

Products division earnings of $104 million were essentially flat compared to 1988. Gains of $197 million from higher sales volumes and prices of refined products were eroded by an increase in crude costs of $135 million and higher marketing expenses. The latter resulted primarily from reidentification to the ''Maximum'' line of refined products.

The loss from Corporate and other activities rose to $99 million from $24 million in 1988 due to higher interest expenses – mainly driven by higher interest rates and an increase in the average debt level – as well as higher unrealized intersegment profits in inventory and a reduction in foreign exchange gains.

Cash flow return on capital employed, reflecting lower cash flow on a before-interest basis, was down from 11.7 per cent to 11.0 per cent. Return on capital employed moved from 1.1 per cent to 3.2 per cent, while return on equity was 3.1 per cent, up from a negative 0.8 per cent in 1988. The latter two indicators reflect the turnaround in earnings.

Internally generated cash

Working capital provided from operations, which eliminates the impact of exploration expenses and non-cash transactions on earnings, declined to $569 million from $624 million in 1988. This decline occurred in the Products division. Proceeds from asset sales net of deliveries of prepaid natural gas added $92 million to cash flow in 1989, compared to a decrease of $1 million in 1988. The higher 1989 amount, which reflects the initiation of the Corporation's divestiture program, pushed internally generated cash from operations to $661 million, up from the 1988 level of $623 million.

Summary of internally generated cash

(stated in millions of dollars)	**1989**	1988
Working capital provided from operations	**569**	624
Proceeds from sale of assets net of advances on future natural gas deliveries	**92**	(1)
Internally generated cash from operations	**661**	623
(Increase) decrease in operating working capital	**(185)**	203
	476	826

Business conditions

Economy
- seven years of successive growth
- slowdown in economic activity in last quarter of 1989
- slowdown could weaken demand for refined products and natural gas in 1990

Free Trade
- agreement reinforces free flow of energy products between Canada and the United States
- should have a generally positive impact through more open access to U.S. markets, especially for natural gas

Federal Goods and Services Tax
- targeted for implementation in 1991
- could put upward pressure on inflation during transition period; should have positive effect thereafter
- may result in some short-term slackening in domestic demand growth for refined products and natural gas

Business conditions more specific to the Products and Resources divisions are discussed in those chapters. A general discussion is included in the Feature Article.

Including the effects of the extraordinary item, operating working capital requirements rose by $185 million in 1989. This increase occurred primarily in the Products division where higher crude prices were reflected in the inventories of crude oil and refined products. Related but largely offsetting increases were also experienced in the Products division's accounts receivable and accounts payable. The 1988 decrease in operating working capital of $203 million resulted mainly from the effect of lower crude oil prices on downstream inventories. The year-end investment in operating working capital – current assets less cash and short-term deposits, and accounts payable and accrued liabilities – stood at $688 million compared with $606 million at the end of 1988.

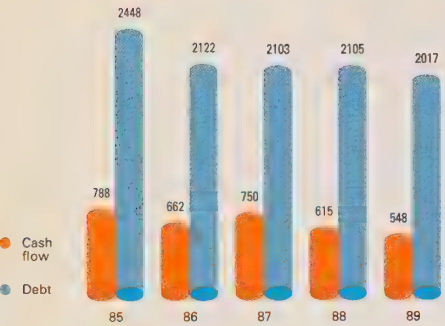
Investment activities

In 1989, expenditures on property, plant, equipment and exploration totaled $567 million, a 29 per cent decrease from 1988. The natural resources segment accounted for 59 per cent of the outlays, compared with 76 per cent in 1988. Refining, marketing and other expenditures accounted for 41 per cent in 1989 and 24 per cent in 1988. The Corporation's reinvestment ratio of 1.03 in 1989 and 1.30 in 1988 reflects an aggressive expenditure program aimed at improving earnings and cash flow while strengthening Petro-Canada's competitive position.

The Resources division spent $334 million on exploration, development and oil sands, with a focus on Western Canada natural gas and international exploration. Expenditures for conventional activities in Western Canada were $99 million for exploration and $153 million for development. Spending in international areas was $59 million and in oil sands and frontier $32 million. In 1988, acquisitions of $101 million for natural gas production properties, combined with a number of promising development opportunities in Western Canada, pushed expenditures to $611 million.

Refining, marketing and other expenditures on property, plant and equipment were up by $45 million in 1989 to $233 million as the Products division continued with its capital program to enhance operating efficiencies at refineries and meet legislated requirements for the phase-out of leaded gasolines. In addition, upgrading of wholesale and retail marketing sites, including the replacement of underground storage tanks, was continued. Downstream and other capital expenditures of $188 million in 1988 were largely directed to marketing network enhancements, refinery upgrades to meet octane requirements and the integration of the Edmonton and Port Moody refineries.

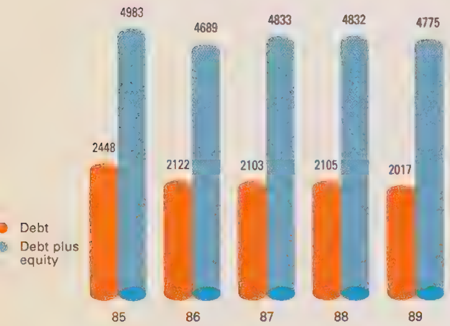
In 1989, equity investments contributed net funds of $76 million through a $95 million partial repayment of advances by Petro-Canada Centre to Petro-Canada. Offsetting this inflow was a $16 million investment in shares of Westcoast Energy Inc. by way of dividend reinvestment and direct purchases. Investments in 1988 of $52 million were primarily for Westcoast share purchases. These share purchases have enabled Petro-Canada to maintain a significant equity position in Westcoast, representing approximately 37 per cent of that company's outstanding common stock. Increases in deferred charges in 1989 and 1988 of $18 million were largely due to additional pension funding.



Cash flow to debt (per cent)

85	86	87	88	89
32.2	31.2	35.7	29.2	27.2

Cash flow to debt
(millions of dollars)



Debt to debt plus equity (per cent)

85	86	87	88	89
49.1	45.3	43.5	43.6	42.2

Debt to debt plus equity
(millions of dollars)

Interest coverage
(times)

Subject to business conditions, the Corporation anticipates that capital and exploration expenditures in 1990 will approach $1.2 billion, an increase of about $600 million over 1989. Of the increase, approximately $275 million will be related to the purchase of the Inter-City Gas Corporation's propane assets and $120 million is for the MTBE project. The balance of the increase will be directed mainly to oil and natural gas activities, including offshore development. Sales of assets are expected to accelerate in 1990, with a planned realization in excess of $300 million in proceeds. A broad range of upstream and downstream assets is being considered. Divestitures are an essential component of funding for the 1990 capital and exploration expenditure program and will continue into 1991 and 1992 as the Corporation further rationalizes its asset base.

Financing activities

At the end of 1989, Petro-Canada's combined short- and long-term debt level was $1 948 million, a reduction of $62 million from the previous year. This decrease is comprised of a new long-term debt issue of $232 million offset by a reduction in short-term notes payable of $258 million and a favourable translation adjustment pertaining to U.S. dollar denominated long-term debt. Consequently, the short-term portion of combined debt dropped significantly from 48 per cent in 1988 to 36 per cent at year end. New long-term debt consisted of a placement of U.S. $200 million, 30-year debentures with a coupon rate of 8.80 per cent which can be redeemed at the option of the holder in 2004. This financing was undertaken to reduce short-term notes payable and thereby lessen the Corporation's exposure to fluctuations in short-term interest rates. In 1988, financing activities centred around the $883 million redemption of preferred shares. This redemption was financed by $361 million of long-term debt and additional short-term notes.

During 1989, Petro-Canada Centre Finance Inc., 50 per cent owned by Petro-Canada, negotiated a private Canadian offering of $125 million, five-year debentures with a coupon rate of 10 per cent. This off balance sheet financing pertains to the Petro-Canada Centre head office complex in Calgary in which the Corporation holds a 50 per cent joint venture interest. Proceeds from the financing were used in part to repay $95 million due to Petro-Canada. As at December 31, 1989, the Corporation has guaranteed $227 million of debt related to the facility, fully secured by a series of underlying debentures. In addition to the $125 million issued in 1989, this debt also comprises two $50 million private placements at 8.92 per cent and 10.10 per cent maturing in 1993.

The Corporation's cash flow to debt ratio stood at 27.2 per cent at year end compared with 29.2 per cent in 1988. The year-over-year decrease stemmed from lower cash flows. Debt as a percentage of debt plus equity improved from 43.6 per cent to 42.2 per cent owing to the lower year-end debt level. Interest coverage (earnings basis) increased to 1.8 in 1989 from 1.0 in 1988 due to improved earnings, while weaker cash flows dropped the cash-based ratio from 4.9 to 3.9 times.

Financing policies and outlook

Petro-Canada's recent long-term debt issues have served to lengthen the average term to maturity of the Corporation's long-term debt to approximately 15 years. To the extent that this capital finances long-term assets or a specific long-term commitment, the average term will be maintained or increased with a view to matching the average life of the Corporation's assets. Short-term debt will continue to be used primarily for working capital and bridge financing purposes. In addition to meeting general corporate requirements, future long-term debt issues will be utilized to finance capital expenditures, refinance short-term debt and finance other corporate activities.

As a major integrated oil and gas company, Petro-Canada generates direct revenues in both Canadian and U.S. dollars. Because crude oil and natural gas production is traditionally priced in U.S. dollars, significant revenues are affected by fluctuations in the value of the Canadian dollar against the U.S. dollar. In order to reduce currency exposure, the Corporation's borrowing requirements are funded primarily in U.S. dollars, thereby providing a partial hedge against such fluctuations. The Corporation continually monitors its foreign currency requirements and maintains a policy of review and application of hedging strategies to mitigate any risk of loss due to currency fluctuations.

In January 1990, Petro-Canada placed a U.S. $300 million issue of 8.60 per cent debentures due in 2010. Overall debt levels are expected to increase by about $200 million in 1990, based upon Petro-Canada's business outlook and planned investments and capital expenditures. As a Crown corporation, Petro-Canada has been able to finance as an agent of the Government of Canada and could take advantage of the highest credit rating (''AAA'') for its debt instruments. In order to facilitate Petro-Canada's timely access to the U.S. domestic market, the Corporation files annual shelf registrations with the Securities and Exchange Commission in Washington, D.C. As of February 1990, the Corporation had unused capacity of U.S. $400 million available on its shelf registration.

On the basis that a signed agreement is in place by mid 1990 to proceed with the development of Hibernia, the Corporation should incur approximately $1 billion of estimated net pre-production expenditures over the 1990 to 1996 period. Significant expenditures would commence in 1991, amounting to about $105 million, with a further $200 million in 1992 and 1993. Government guaranteed project-related financing would cover approximately 40 per cent of pre-production development costs; the remainder would be funded by way of internally generated cash and general corporate financings.

Added commitments in the 1990s, specifically for megaprojects, point to the need for additional financing requirements. In spite of risk sharing with governments through direct government grants, guaranteed debt, interest assistance facilities and lender risk sharing on such projects, considerable risk will accrue to Petro-Canada as a participant. While megaprojects could be funded by special debt issues with repayments related to project cash flows, prudent management dictates the necessity of significant equity infusions to balance appropriately the Corporation's capital structure.

Glossary of Financial Ratio Terms

Cash flow
Working capital provided from operations (as disclosed in the financial statements) less dividends on redeemable preferred shares plus investment tax credits, exploration tax credits and changes in advances on future natural gas deliveries.

Capital employed
Total assets less current liabilities excluding short-term notes payable and the current portion of long-term debt.

Debt
Long-term debt including current portion of long-term debt, short-term notes payable, outstanding cheques less cash, advances on future natural gas deliveries and redeemable preferred shares valued at year-end Cdn./U.S. dollar exchange rates.

Equity
Shareholder's equity adjusted for the valuation of redeemable preferred shares at year-end Cdn./U.S. dollar exchange rates.

Cash flow to debt
Cash flow divided by debt.

Debt to debt plus equity
Debt divided by debt plus year-end equity.

Interest coverage
Earnings basis: Earnings before interest expenses, provision for income taxes, extraordinary and unusual items and dividends on redeemable preferred shares divided by interest expense plus capitalized interest plus dividends on redeemable preferred shares multiplied by 1/1-tax rate.

Cash flow basis: Working capital provided from operations before interest expenses and provision for current income taxes plus changes in advances on future natural gas deliveries divided by interest expense plus capitalized interest plus dividends on redeemable preferred shares multiplied by 1/1-tax rate.

Reinvestment ratio
Expenditures on property, plant and equipment and exploration less Petroleum Incentive Program grants divided by cash flow.

Cash flow return on capital employed
Cash flow plus tax adjusted interest expense and dividends on redeemable preferred shares divided by average capital employed.

Return on capital employed
Earnings before extraordinary and unusual items and dividends on redeemable preferred shares plus tax adjusted interest expense, divided by average capital employed.

Return on equity
Earnings before extraordinary and unusual items and after dividends on redeemable preferred shares, divided by average equity.

Management's Responsibility for the Financial Statements

The financial statements have been prepared by management in accordance with generally accepted accounting principles appropriate in the circumstances. Management is responsible for the other information in the Annual Report, which is consistent, where applicable, with that contained in the financial statements. Management is also responsible for installing and maintaining a system of internal control to provide reasonable assurance that reliable financial information is produced. The Corporation has an internal audit department whose functions include reviewing the system of internal control to ensure that it is adequate and functioning properly.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, a majority of which is composed of directors who are not employees of the Corporation. The committee meets with management, the internal auditors and the external auditors to satisfy itself that responsibilities are properly discharged and to review the financial statements.

The external auditors conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their examination includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board.

Auditors' Report

To the Honourable Jake Epp, P.C., M.P.
Minister, Energy, Mines and Resources Canada
House of Commons, Ottawa, Ontario

We have examined the consolidated balance sheets of Petro-Canada (incorporated by Special Act of the Parliament of Canada) as at December 31, 1989 and 1988 and the related consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1989 and 1988 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change in the method of accounting for oil and gas exploration, development and production activities as explained in Note 2 to the consolidated financial statements, on a consistent basis.

Further, we have examined the transactions of the Corporation and its consolidated wholly owned subsidiaries that came to our notice in the course of the above mentioned examinations, to determine whether they were in accordance with Part X of the Financial Administration Act, the regulations, the charter and by-laws of the Corporation and its consolidated wholly owned subsidiaries and any directives given to the Corporation pursuant to the Act. Our examinations of these transactions were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. In our opinion, these transactions were, in all significant respects, in compliance with the authorities specified.

Arthur Andersen & Co.
Chartered Accountants

Calgary, Alberta
February 22, 1990

Consolidated Statement of Earnings

For the year ended December 31, 1989
(stated in millions of dollars)

	1989	1988 (Restated) (Note 2)
Revenue		
Operating	$ 4 852	$ 4 669
Investment and other income	165	132
	5 017	4 801
Expenses		
Crude oil and product purchases	1 977	1 939
Marketing, general and administrative	972	891
Producing and refining	814	777
Exploration	98	114
Depreciation, depletion and amortization	401	536
Federal sales and other taxes	384	383
Interest on long-term debt	101	71
Other interest	101	60
	4 848	4 771
Earnings before Undernoted Items	169	30
Provision for Income Taxes (Note 3)		
Current	47	52
Deferred	37	(11)
	84	41
Earnings (Loss) before Extraordinary Item and Dividends on Redeemable Preferred Shares	85	(11)
Extraordinary Item (Note 4)	54	22
Net Earnings (Loss) before Dividends on Redeemable Preferred Shares	31	(33)
Dividends on Redeemable Preferred Shares (Note 5)	–	10
Net Earnings (Loss) after Dividends on Redeemable Preferred Shares	$ 31	$ (43)

Consolidated Statement of Retained Earnings

For the year ended December 31, 1989
(stated in millions of dollars)

	1989	1988 (Restated) (Note 2)
Retained Earnings (Deficit) at Beginning of Year	**$ (1 434)**	$ (1 340)
Transfer from contributed surplus (Note 14)	**1 434**	–
Net earnings (loss) before dividends on redeemable preferred shares	**31**	(33)
Dividends on redeemable preferred shares	–	(10)
Exchange adjustment on redemption of redeemable preferred shares	–	(51)
Retained Earnings (Deficit) at End of Year	**$ 31**	$ (1 434)

Consolidated Statement of Changes in Financial Position

For the year ended December 31, 1989
(stated in millions of dollars)

	1989	1988 (Restated) (Note 2)
Internally Generated Cash		
Working capital provided from operations (Note 6)	**$ 569**	$ 624
Proceeds from sale of assets	**118**	22
Advances on future natural gas deliveries	**(26)**	(23)
Internally generated cash from operations	**661**	623
(Increase) decrease in operating working capital (Note 7)	**(185)**	203
	476	826
Investment Activities		
Expenditures on property, plant and equipment and exploration	**567**	799
(Decrease) increase in investments, net	**(76)**	52
Increase in deferred charges, net	**18**	18
	509	869
Financing Activities and Dividends		
Proceeds from issue of long-term debt	**240**	361
(Decrease) increase in short-term notes payable, net	**(258)**	655
Reduction of long-term debt	**(6)**	(6)
Redemption of redeemable preferred shares	**–**	(883)
Dividends on redeemable preferred shares	**–**	(10)
	(24)	117
(Decrease) Increase in Cash	**(57)**	74
Cash and Short-Term Deposits at Beginning of Year	**84**	10
Cash and Short-Term Deposits at End of Year	**$ 27**	$ 84

Consolidated Balance Sheet

As at December 31, 1989
(stated in millions of dollars)

	1989	1988 (Restated) (Note 2)
Assets		
Current Assets		
Cash and short-term deposits	**$ 27**	$ 84
Accounts receivable	**807**	734
Inventories (Note 8)	**677**	560
Income taxes recoverable	**34**	36
Prepaid expenses	**45**	41
	1 590	1 455
Investments (Note 9)	**467**	539
Property, Plant and Equipment, net (Note 10)	**4 668**	4 675
Deferred Charges (Note 11)	**93**	83
	$ 6 818	$ 6 752
Liabilities and Shareholder's Equity		
Current Liabilities		
Short-term notes payable	**$ 710**	$ 968
Accounts payable and accrued liabilities	**875**	765
Current portion of long-term debt	**6**	6
	1 591	1 739
Long-Term Debt (Note 12)	**1 232**	1 036
Deferred Credits (Note 13)	**231**	213
Deferred Income Taxes	**1 006**	1 037
Shareholder's Equity (Note 14)	**2 758**	2 727
	$ 6 818	$ 6 752

Approved on behalf of the Board

Director

Director

Note 1: Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada, an agent of Her Majesty in right of Canada, and of all subsidiary companies (''the Corporation'') except Canertech Inc., which is excluded for the reason described in Note 9.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition is attributed to the related assets acquired and is amortized over the life of these assets.

(b) Inventories

Inventories are stated at the lower of cost and net realizable value. Cost of crude oil, refined products and merchandise is determined on a ''first-in, first-out'' basis.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity method. Other long-term investments are accounted for on the cost method.

(d) Property, Plant and Equipment

The Corporation accounts for its investment in exploration and development activities on the successful efforts method (Note 2). Under this method the acquisition cost of unproved acreage is capitalized. Costs of exploratory wells are initially capitalized pending determination of proved reserves and costs of wells which are assigned proved reserves remain capitalized while costs of unsuccessful wells are charged to earnings. All other exploration costs are charged to earnings as incurred. Development costs, including the cost of all wells, are capitalized.

Substantially all of the Corporation's exploration and development activities are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

The interest cost of debt attributable to the construction of major new facilities is capitalized during the construction period.

Overburden removal costs relating to oil sands which will be mined in future years are deferred and are charged to earnings when the related oil sands are mined.

(e) Depreciation, Depletion and Amortization

The carrying amounts of significant unproved properties are evaluated periodically for impairment with any such impairment being charged to earnings. The cost of other unproved properties is amortized over their average holding period.

Depreciation and depletion of capitalized costs of oil and gas producing properties is calculated using the unit of production method. The Corporation applies a ''ceiling test'' to capitalized costs in each individual field to ensure that such costs do not exceed the fair market value of the related proved reserves.

Depreciation of other plant and equipment is provided on either the unit of production method or the straight line method as appropriate. Straight line depreciation rates are based on the estimated service lives of the related assets.

(stated in millions of dollars)

Note 1: (Continued)

(f) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming depreciation, exploration, development and other costs for income tax purposes which differ from the related amounts charged to earnings.

(g) Translation of Foreign Currency

Current assets, except inventories and prepaid expenses, current liabilities and long-term debt are translated at rates of exchange in effect at the balance sheet date. Long-term assets, inventories, prepaid expenses, deferred income taxes, redeemable preferred shares and revenue and expense items are translated at rates of exchange in effect at the respective transaction dates. Depreciation, depletion and amortization expense reflects rates of exchange in effect when the related assets were acquired.

The resulting exchange gains or losses are included in earnings, except for unrealized exchange gains or losses arising on translation of long-term debt, which are deferred and amortized over the remaining term of the debt.

Foreign operations are integrated with the Corporation's other activities and are translated in the manner described above.

(h) Postemployment Benefits

In addition to its pension plans the Corporation provides for other postemployment benefits, including health, dental and life insurance, to its qualifying retirees. The cost of these benefits is charged to earnings when paid by the Corporation.

Note 2: Change in Accounting Policy

Effective January 1, 1989 the Corporation retroactively adopted the successful efforts method of accounting for its investment in exploration and development activities [Note 1(d) & (e)]. Previously the Corporation had followed the full cost method of accounting. This change, which increased 1989 net earnings by $19 million, resulted in the following adjustments to previously reported 1988 amounts.

1988 Balances	Balance as Previously Reported	Adjustment	Balance as Restated
Opening retained earnings (deficit)	$ (289)	$ (1 051)	$ (1 340)
Property, plant and equipment, net	6 534	(1 859)	4 675
Deferred income taxes	1 708	(671)	1 037
Closing retained earnings (deficit)	(246)	(1 188)	(1 434)
Net earnings (loss) after dividends on redeemable preferred shares	94	(137)	(43)

Notes to Consolidated Financial Statements

December 31, 1989
(stated in millions of dollars)

Note 3: Income Taxes

The provision for income taxes of $84 million (1988 – $41 million) represents an effective rate of 49.7% (1988 – 136.7%) on earnings before income taxes of $169 million (1988 – $30 million). The computation of the provision, which requires adjustment to earnings before income taxes for non-taxable and non-allowable items, is as follows:

	1989	1988
Earnings before income taxes	**$ 169**	$ 30
Add (deduct)		
Royalties and other payments to provincial governments	**137**	135
Federal allowances		
Resource allowances	**(111)**	(107)
Tax depletion	**(41)**	(8)
Non-deductible depreciation, depletion and amortization	**82**	90
Non-taxable gains	**(7)**	(14)
Equity in earnings of affiliates	**(31)**	(21)
Other	**(8)**	4
Earnings as adjusted before income taxes	**$ 190**	$ 109
Canadian Federal income tax at 39.5% (1988 – 42.4%) applied to earnings as adjusted	**$ 75**	$ 46
Provincial and other income taxes, net of federal abatement	**14**	–
Provincial income tax rebates	**(5)**	(5)
Provision for income taxes	**$ 84**	$ 41

Note 4: Extraordinary Item

During 1989 the Corporation commenced an internal reorganization program which resulted in a staff reduction. The cost of this program, in the amount of $54 million (after deducting related income taxes of $38 million) was charged to 1989 earnings.

During 1988 the Corporation wrote down the carrying value of its investment in Sedpex Inc. (Note 9) due to uncertain dayrates and low utilization of offshore drilling rigs. The amount of this charge to earnings was $22 million including related income taxes of $2 million.

Note 5: Redeemable Preferred Shares

During 1988 a subsidiary redeemed 7 092 983 shares for a consideration of U.S. $709 million. The 1988 redemption comprised virtually all the remaining outstanding shares.

Notes to Consolidated Financial Statements

December 31, 1989
(stated in millions of dollars)

Note 6: Working Capital Provided from Operations

		1989		1988
Earnings (loss) before extraordinary item and dividends on redeemable preferred shares	$	**85**	$	(11)
Add (deduct)				
Depreciation, depletion and amortization		**401**		536
Exploration expense		**98**		114
Deferred income taxes		**37**		(11)
(Gain) loss on sale of assets		**(37)**		2
Equity earnings, net of dividends received		**(6)**		2
Other		**(9)**		(8)
	$	**569**	$	624

Note 7: (Increase) Decrease in Operating Working Capital

		1989		1988
Accounts receivable	$	**(73)**	$	158
Inventories		**(117)**		161
Income taxes recoverable		**2**		(32)
Prepaid expenses		**(4)**		12
Accounts payable and accrued liabilities		**110**		(99)
Extraordinary item		**(92)**		–
Other		**(11)**		3
	$	**(185)**	$	203

Operating working capital is comprised of working capital other than cash and short-term deposits, short-term notes payable and current portion of long-term debt.

Note 8: Inventories

		1989		1988
Crude oil, refined products and merchandise	$	**615**	$	495
Materials and supplies		**62**		65
	$	**677**	$	560

Note 9: Investments

		1989		1988
At equity				
Westcoast Energy Inc.	$	**293**	$	269
Petro-Canada Centre		**94**		189
Sedpex Inc.		**18**		18
Other		**24**		22
At cost				
Mortgages and other investments		**38**		41
	$	**467**	$	539

(stated in millions of dollars)

Note 9: (Continued)

Westcoast Energy Inc. ("Westcoast")

At December 31, 1989 the Corporation held approximately 37% (1988 - 37%) of the outstanding common shares of Westcoast with a quoted market value of $378 million (1988 - $280 million).

Petro-Canada Centre

The Corporation holds 50% of a joint venture which owns Petro-Canada Centre, an office complex in Calgary. The Corporation has entered into a long-term lease for use of a portion of the complex and, as at December 31, 1989, has guaranteed $227 million of long-term debt related to the facility.

Sedpex Inc.

The Corporation holds 50% of the outstanding common shares of Sedpex Inc., a company which owns a semi-submersible drilling vessel.

Canertech Inc. ("Canertech")

The accounts of Canertech, a wholly owned subsidiary company, have been excluded from consolidation because a formal plan exists to dispose of the investment in the subsidiary. In response to a directive by the Government of Canada, the Corporation incorporated Canertech in 1981 to develop alternate energy sources. At that time the Government indicated its intention of purchasing the Corporation's investment at cost and establishing Canertech as an independent Crown corporation. The Corporation is proceeding with the implementation of a Government directive to bring about the dissolution of Canertech. The Corporation's investment in Canertech is carried in the accounts at its original cost of one dollar.

Note 10: Property, Plant and Equipment

	1989			1988			1989	1988
	Cost	Accumulated Depreciation, Depletion and Amortization	Net	Cost	Accumulated Depreciation, Depletion and Amortization	Net	Capital Expenditures	
Natural Resources								
Oil and gas								
Canada	$ 3 923	$ 2 153	$ 1 770	$ 3 867	$ 2 033	$ 1 834	$ 187	$ 441
Foreign	87	57	30	67	52	15	22	3
Oil sands								
Syncrude Project	764	173	591	751	153	598	13	42
Other oil sands	219	219	–	212	212	–	7	5
Natural gas liquids	217	103	114	210	89	121	4	4
Other	76	53	23	105	81	24	3	2
	5 286	2 758	2 528	5 212	2 620	2 592	236	497
Refining and Marketing	2 700	693	2 007	2 495	550	1 945	208	159
Other Property, Plant and Equipment	322	189	133	299	161	138	25	29
	$ 8 308	$ 3 640	$ 4 668	$ 8 006	$ 3 331	$ 4 675	$ 469	$ 685

Capital expenditures for the year include $ nil (1988 – $12 million) of capitalized interest expense.

Notes to Consolidated Financial Statements

December 31, 1989
(stated in millions of dollars)

Note 11: Deferred Charges

	1989	1988
At cost		
Oil sands overburden removal costs	$ 43	$ 39
Less portion related to oil sands to be mined within one year	18	17
	25	22
Deferred pension funding	36	27
At amortized cost		
Deferred financing costs	17	17
Other	15	17
	$ 93	$ 83

Note 12: Long-Term Debt

	Maturity	1989	1988
In Canadian dollars			
8.25% unsecured notes	1993	$ 11	$ 11
In United States dollars			
7.75% unsecured notes (U.S. $12 million)	1993	14	15
LIBOR less 0.8% unsecured notes (U.S. $125 million)	1995	144	149
9% unsecured notes (U.S. $23 million)	1995	26	31
7.25% unsecured debentures (U.S. $200 million)	1996	232	239
9.50% unsecured debentures (U.S. $200 million)	2003	232	239
8.25% unsecured debentures (U.S. $200 million)	2016	232	239
9.70% unsecured debentures (U.S. $100 million)	2018	115	119
8.80% unsecured debentures (U.S. $200 million)	2019*	232	–
		1 238	1 042
Less current portion		6	6
		$ 1 232	$ 1 036

*Redeemable in 2004 at the option of the holder thereof.

Repayment of long-term debt

The minimum repayment of long-term debt in each of the next five years is as follows:
1990 – $6 million 1991 – $6 million 1992 – $7 million 1993 – $24 million 1994 – $4 million

Notes to Consolidated Financial Statements

December 31, 1989
(stated in millions of dollars)

Note 13: Deferred Credits

	1989	1988
Translation adjustment on long-term debt	$ 114	$ 88
Advances on future natural gas deliveries	69	95
Long-term liabilities	48	30
	$ 231	$ 213

Note 14: Shareholder's Equity

Authorized Capital

(a) 71 188 common shares with a par value of one hundred thousand dollars each, and

(b) Preferred shares issued to the Government of Canada provided that the amount of such shares together with any loans received, and outstanding, from the Consolidated Revenue Fund of the Government of Canada is not in excess of one billion dollars. These shares have a par value of one dollar each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

Issued (to the Government of Canada)

	1989		1988	
	Number of Shares		Number of Shares	
Common shares	17 540	$ 1 754	31 883	$ 3 188
Preferred shares	972 771 853	973	972 771 853	973
Total capital		2 727		4 161
Retained earnings (deficit)		31		(1 434)
		$ 2 758		$ 2 727

Contributed Surplus

During 1989 the Board of Directors approved the adoption of the successful efforts method of accounting which resulted in a decrease in retained earnings to a deficit of $1 434 million as at January 1, 1989. It was contemplated that this deficit would be offset against capital, subject to shareholder's approval. On February 21, 1990, His Excellency the Governor General in Council approved the surrender for cancellation of 14 343 common shares. This surrender and cancellation of these shares resulted in a contributed surplus of $1 434 million. Shareholder's equity at December 31, 1989 has been adjusted to give effect to the contributed surplus and its offset against the deficit.

Note 15: Pension Plans

The Corporation's plans are defined benefit plans with the benefits generally based upon years of service and average salary during the final years of employment. They are funded by the Corporation based upon the advice of an independent actuary.

Plan Status as at December 31

	1989	1988
Actuarial value of assets	$ 495	$ 445
Pension obligation	470	427
Net pension asset	$ 25	$ 18

(stated in millions of dollars)

Note 15: (Continued)

The net pension asset is amortized to earnings over the expected average remaining service life of the employees covered by the plans, which is currently 12 years.

Pension funding and expense amounted to $29 million (1988 - $32 million) and $17 million (1988 – $16 million) respectively.

Note 16: Related Party Transactions

Transactions with the Government of Canada and its agencies are in the normal course of business and are therefore on the same terms as those accorded to non-related parties.

Note 17: Segmented Information

The Corporation operates in two business segments:

Natural resources, comprising: exploration, development, production, transportation and marketing activities for crude oil, natural gas, field liquids, sulphur and oil sands; and extraction of liquids from natural gas.

Refining and marketing, comprising: purchase and sale of crude oil; refining crude oil into oil products; and distribution and marketing of these and other purchased products.

Financial information by business segment is presented in the following table as though each segment were a separate business entity. Inter-segment transfers of products, which are accounted for at market value, are eliminated on consolidation. Corporate and other includes investment income, interest expense and unallocated general corporate revenues and expenditures. Corporate and other assets are principally cash and short-term deposits, investments in other companies and general corporate assets.

	Natural Resources		Refining and Marketing		Corporate and Other		Consolidated	
	1989	1988	**1989**	1988	**1989**	1988	**1989**	1988
Revenue								
Sales to customers and other revenues	**$ 502**	$ 473	**$ 4 442**	$ 4 245	**$ 73**	$ 83	**$ 5 017**	$ 4 801
Inter-segment sales	**640**	516	**–**	–	**–**	–		
Segment Revenue	**$ 1 142**	$ 989	**$ 4 442**	$ 4 245	**$ 73**	$ 83		
Earnings								
Operating earnings before depreciation, depletion and amortization	**$ 518**	$ 415	**$ 339**	$ 336	**$ 13**	$ 60	**$ 870**	$ 811
Depreciation, depletion and amortization	**(249)**	(388)	**(147)**	(142)	**(5)**	(6)	**(401)**	(536)
Exploration expense	**(98)**	(114)	**–**	–	**–**	–	**(98)**	(114)
Interest	**–**	–	**–**	–	**(202)**	(131)	**(202)**	(131)
Provision for income taxes	**(91)**	(2)	**(88)**	(92)	**95**	53	**(84)**	(41)
Earnings (Loss) before Extraordinary Item and Dividends on Redeemable Preferred Shares	**$ 80**	$ (89)	**$ 104**	$ 102	**$ (99)**	$ (24)	**$ 85**	$ (11)
Capital and Exploration Expenditures								
Property, plant and equipment and exploration expenditures	**$ 334**	$ 611	**$ 208**	$ 159	**$ 25**	$ 29	**$ 567**	$ 799
Investments	**–**	–	**(1)**	1	**(75)**	51	**(76)**	52
Deferred charges	**4**	(1)	**3**	2	**11**	17	**18**	18
	$ 338	$ 610	**$ 210**	$ 162	**$ (39)**	$ 97	**$ 509**	$ 869
Total Assets	**$ 2 786**	$ 2 870	**$ 3 394**	$ 3 101	**$ 638**	$ 781	**$ 6 818**	$ 6 752
Capital Employed	**$ 2 551**	$ 2 650	**$ 2 810**	$ 2 585	**$ 582**	$ 752	**$ 5 943**	$ 5 987

Notes to Consolidated Financial Statements

December 31, 1989
(stated in millions of dollars)

Note 18: Comparative Figures

Certain reclassifications have been made to the 1988 comparative figures to conform with the current year's presentation.

Note 19: Commitments and Contingencies

Commitments

(a) The Corporation has leased property and equipment under various long-term operating leases for periods up to 2008. The minimum annual rentals for non-cancellable operating leases are estimated at $55 million in 1990, $53 million in 1991, $53 million in 1992, $44 million in 1993, $41 million in 1994 and $23 million per year thereafter until 2008.

(b) Pursuant to an agreement reached on December 11, 1989 with Westcoast Energy Inc. the Corporation has agreed to purchase the propane business of Inter-City Gas Corporation (''ICG'') for a consideration of $265 million plus an earnings adjustment. The purchase is conditional on obtaining certain regulatory approvals and the approval of ICG's shareholders. It is anticipated this transaction will close near the end of the first quarter of 1990.

Contingencies

The Corporation is involved in litigation and claims associated with normal operations. Management is of the opinion that any resulting settlements would not materially affect the financial position of the Corporation.

Note 20: Subsequent Events

(a) On January 10, 1990 the Corporation sold U.S. $300 million of 8.60% debentures due January 15, 2010. The net proceeds of the sale of approximately $345 million (U.S. $297 million) were used to reduce short-term indebtedness.

(b) On February 20, 1990 the Government of Canada announced its intention to introduce legislation in 1990 to authorize the Corporation to sell share capital to the public. An initial public offering of treasury shares is expected to be followed by further share issues over a number of years. The arrangements for the sale of shares, which have not been finalized, will include changes to the Corporation's capital structure and legal status.

Reserves Information
(proved reserves, net after royalties)

	1989 Developed	1989 Undeveloped	1989 Total	1988 Developed	1988 Undeveloped	1988 Total
Crude oil and natural gas liquids (millions of barrels)						
Conventional crude oil	**174.2**	**11.1**	**185.3**	195.8	33.6	229.4
Synthetic crude oil	**194.5**	**18.0**	**212.5**	198.3	20.3	218.6
Natural gas liquids	**33.4**	**3.6**	**37.0**	33.0	3.9	36.9
Total	**402.1**	**32.7**	**434.8**	427.1	57.8	484.9
Natural gas (billions of cubic feet)	**2 033.2**	**669.5**	**2 702.7**	2 097.8	715.2	2 813.0

	1989 Conventional oil and NGL (millions of barrels)	1989 Synthetic crude oil (millions of barrels)	1989 Natural gas (billions of cubic feet)	1988 Conventional oil and NGL (millions of barrels)	1988 Synthetic crude oil (millions of barrels)	1988 Natural gas (billions of cubic feet)
Balance at beginning of year	**266.3**	**218.6**	**2 813.0**	248.7	212.5	2 776.4
Revisions of previous estimates	**(17.2)**	**2.9**	**48.2**	39.1	15.2	32.5
Extension and discoveries	**2.5**	–	**23.1**	2.2	–	34.2
Purchases	**0.9**	–	**20.5**	–	–	114.6
Sales	**(7.9)**	–	**(34.2)**	–	–	–
Production	**(22.3)**	**(9.0)**	**(167.9)**	(23.7)	(9.1)	(144.7)
Balance at end of year	**222.3**	**212.5**	**2 702.7**	266.3	218.6	2 813.0

Notes:
1. Reserves quantities in the Annual Report, excluding synthetic crude oil, are reported based on estimates consistent with the knowledge of the characteristics and extent of underlying productive formations at each year end.
2. The above figures include Petro-Canada's 17 per cent interest in the synthetic crude oil reserves of Syncrude. These reserves are based on the demonstrated production capacity of the Syncrude plant calculated over the remaining term of the current operating permit to the year 2013. The Syncrude project is subject to a royalty agreement between the Province of Alberta and the Syncrude participants whereby the Province has the right to 50 per cent of Syncrude's deemed net profit. The Province has an option to convert its royalty to a 7.5 per cent gross overriding royalty. The net after-royalty reserves of Syncrude are based on an estimated average royalty rate for the life of the project based on deemed net profits and current prices and operating costs.

Reserves and Production Discussion

- Proved reserves of conventional oil and NGL declined from year-end 1988 due in part to the sale of non-strategic Western Canada properties and the reclassification of Wolf Lake reserves.
- Natural gas proved reserves decreased by 110 billion cubic feet over 1988, partly as a result of higher production levels and sales of properties.
- Reserves information presented in the accompanying tables does not include potential and probable reserves. Reserves associated with the Hibernia and Terra Nova offshore projects and the OSLO oil sands project will be booked at the time a commitment is made to proceed with development.
- The following two tables list the top conventional oil and natural gas fields, representing about 50 per cent of the Corporation's year-end proved reserves and 1989 production.

Principal Reserves Locations

Conventional oil		Natural gas	
Field	% of proved reserves at December 31, 1989	Field	% of proved reserves at December 31, 1989
Valhalla	11	Hanlan	10
Pembina	8	Whitecourt	7
Bellshill Lake	8	Yoyo	6
Nipisi	6	Medicine Hat	4
Swan Hills	6	Laprise	4
Cactus Lake	5	Ricinus	4
Utikuma	5	Kaybob South	3
Wainwright	4	Brazeau	3
		Alderson	3
		Hatton	2
		Gilby	2
		Clarke Lake	2
	53		50

Principal Production Locations

Conventional oil		Natural gas	
Field	% of 1989 production	Field	% of 1989 production
Bellshill Lake	14	Yoyo	12
Utikuma	8	Hanlan	12
Valhalla	7	Whitecourt	5
Nipisi	6	Laprise	5
Brazeau	5	Clarke Lake	3
Kinsella	4	Jedney	3
Boundary Lake	3	Medicine Hat	2
Provost	3	Cow Lake	2
		Windfall	2
		Kobes Creek	2
		Grassy	2
	50		50

Notes:
1. Reserves and production are net before royalties.
2. Reserves and production locations are plotted on map in Resources division chapter.

Refining and Supply Discussion

- Petro-Canada's refineries produce a full slate of petroleum products. Included in the list are gasolines, aviation fuels, heating oils, heavy fuel oils, diesels, lubricants and asphalts.
- The Mississauga plant of the Lake Ontario refinery produces a wide range of lubricating oils and limited volumes of other petroleum products. The Montreal refinery produces, in addition to petroleum products, a limited quantity of petrochemical feedstocks and solvents. The Edmonton refinery has the capability to process 6 600 cubic metres per day of synthetic crude oil.
- Crude oil and other refinery feedstock requirements are primarily obtained from purchases in domestic markets. Petro-Canada's Western Canada upstream production supplies 31 per cent of the Corporation's refinery requirements.
- Total daily rated refining capacity decreased from 60 600 to 54 200 cubic metres per day as a result of integration measures and the sale of the Moose Jaw asphalt plant.
- Petro-Canada is party to a number of long-term processing agreements. Under these agreements, the Corporation refines crude oil on a fee basis for other industry participants, or other refiners provide similar service to Petro-Canada.

Refining by Locations

	Average daily volume of crude oil processed		Daily rated capacity[1] at December 31		Annual utilization rate	
	1989	1988	**1989**	1988	**1989**	1988
	thousands of cubic metres				per cent	
Montreal, Quebec	**11.8**	10.8	**13.9**	13.9	**85**	78
Lake Ontario, Ontario	**17.0**	15.6	**19.4**	19.4	**88**	79
Edmonton, Alberta[2]	**15.6**	14.7	**18.4**	18.4	**85**	78
Port Moody, British Columbia[3]	**–**	4.9	**–**	4.0	**–**	87
Taylor, British Columbia	**2.1**	1.9	**2.5**	2.8	**84**	64
Moose Jaw, Saskatchewan	**–**	0.6	**–**	2.1	**–**	30
Total	**46.5**	48.5	**54.2**	60.6	**86**	77

Supply Information

	Average daily volumes (thousands of cubic metres)	
	1989	1988
Net domestic supply[4]	**40.1**	45.3
Net foreign purchases	**6.4**	3.2
Processed by Petro-Canada	**46.5**	48.5
Processed for others	**(14.0)**	(14.3)
Processed by others	**11.3**	10.7
Total Petro-Canada requirements	**43.8**	44.9

Notes:
1. Daily rated capacities are based on calendar days and definite specifications as to types of crude oil, the products to be obtained and the refinery processes required. Variations in these factors may result in actual capacities being higher or lower than rated capacities.
2. In 1989, the Edmonton refinery processed sufficient crude to supply the Port Moody, British Columbia facility with 3 600 cubic metres per day of partially processed feedstocks.
3. To better reflect the Edmonton/Port Moody integration, the Port Moody facility was dropped from the 1989 tables. Commencing October 31, 1988, the Port Moody processing volumes consisted solely of partially processed feedstock supplied by the Edmonton refinery.
4. Net domestic supply consists of Petro-Canada's net domestic production plus purchases of domestic crude oil less the Corporation's domestic and export sales of crude oil. In addition, it includes crude oil supplied by others for processing.

Five Year Financial Summary

(stated in millions of dollars)

	1989	1988	1987	1986	1985
Summary of Earnings					
Revenue	**$ 5 017**	$ 4 801	$ 5 079	$ 5 172	$ 5 381
Expenses	**4 848**	4 771	4 765	4 937	5 083
	169	30	314	235	298
Provision for income taxes	**84**	41	173	161	206
Earnings (loss) before extraordinary and unusual items and dividends on redeemable preferred shares	**85**	(11)	141	74	92
Extraordinary and unusual items	**54**	22	–	–	392
Net earnings (loss) before dividends on redeemable preferred shares	**31**	(33)	141	74	(300)
Dividends on redeemable preferred shares	**–**	10	41	59	78
Net earnings (loss) after dividends on redeemable preferred shares	**$ 31**	$ (43)	$ 100	$ 15	$ (378)
Other Financial Data					
Working capital provided from operations	**$ 569**	$ 624	$ 784	$ 728	$ 870
Expenditures on property, plant and equipment and exploration	**567**	799	483	448	710
Increase (decrease) in investments and deferred charges	**(58)**	70	143	81	(326)
Acquisitions including minority interests	**–**	–	–	301	1 010
Total assets	**6 818**	6 752	6 816	6 628	7 424
Average capital employed	**5 965**	5 969	5 779	5 760	6 124
Operating working capital	**688**	606	806	549	971
Long-term debt (Note 3)	**1 238**	1 042	750	818	289
Redeemable preferred shares	**–**	–	831	922	1 224
Shareholder's equity	**2 758**	2 727	2 821	2 732	2 771
Annual Operating Revenues					
Resources Division					
Crude oil and natural gas liquids					
Conventional crude oil	**$ 371**	$ 316	$ 432	$ 349	$ 627
Synthetic crude oil	**192**	166	192	167	279
Field natural gas liquids	**48**	46	57	50	80
	611	528	681	566	986
Natural gas	**246**	222	203	219	292
Sulphur	**21**	23	25	31	34
Natural gas liquids from straddle plants	**167**	152	145	192	235
Other	**97**	64	84	72	89
Total	**$ 1 142**	$ 989	$ 1 138	$ 1 080	$ 1 636

	1989	1988	1987	1986	1985
Annual Operating Revenues (Continued)					
Products Division					
Gasolines	**$ 2 117**	$ 2 050	$ 2 240	$ 2 280	$ 2 232
Distillates	**1 303**	1 284	1 384	1 549	1 350
Other including petrochemicals	**1 022**	911	837	759	768
Total	**$ 4 442**	$ 4 245	$ 4 461	$ 4 588	$ 4 350
Expenditures on Property, Plant and Equipment and Exploration					
Resources Division					
Exploration					
Frontier	**$ 12**	$ 54	$ 41	$ 245	$ 442
Western provinces	**99**	129	101	62	145
Foreign	**51**	23	12	11	19
Development					
Western provinces	**153**	355	138	113	181
Foreign	**8**	3	–	1	6
Oil sands					
Syncrude	**13**	42	44	47	60
Other	**7**	5	5	3	15
	343	611	341	482	868
Products Division					
Refining	**114**	80	49	55	115
Marketing	**94**	79	73	57	50
	208	159	122	112	165
Support facilities	**25**	29	25	20	26
	576	799	488	614	1 059
Petroleum Incentive Program grants	**9**	–	5	166	349
Total	**$ 567**	$ 799	$ 483	$ 448	$ 710
Reinvestment ratio	**1.03**	1.30	0.64	0.68	0.90
Financial Indicators (per cent)					
Performance					
Cash flow return on capital employed	**11.0**	11.7	14.3	13.1	14.3
Return on capital employed	**3.2**	1.1	3.1	1.9	1.7
Return on equity	**3.1**	(0.8)	3.8	0.6	0.5
Leverage					
Cash flow to debt	**27.2**	29.2	35.7	31.2	32.2
Debt to debt plus equity	**42.2**	43.6	43.5	45.3	49.1
Interest coverage (times)					
– earnings basis	**1.8**	1.0	2.4	1.6	1.8
– cash flow basis	**3.9**	4.9	5.7	4.5	5.0

Notes:

1. Financial and operating results are included from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the Edmonton refinery.
2. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
3. Long-term debt includes current maturities

Five Year Operating Summary

	1989	1988	1987	1986	1985
Oil and Gas Landholdings (gross/net)					
(millions of acres)					
Canadian provinces					
Alberta – Oil and natural gas rights	**5.1/2.4**	5.3/2.6	5.4/2.6	5.8/2.8	6.4/3.1
– Oil sands rights	**2.4/.9**	2.5/.7	2.5/.9	2.7/1.0	2.6/.9
British Columbia	**2.1/1.3**	2.2/1.4	2.2/1.3	2.7/1.5	3.1/1.7
Saskatchewan	**.7/.5**	.7/.5	.5/.3	.5/.4	.5/.3
Other provinces	**.1/.1**	.3/.2	.3/.2	.8/.5	.9/.5
	10.4/5.2	11.0/5.4	10.9/5.3	12.5/6.2	13.5/6.5
Frontier Canada	**15.1/11.4**	16.2/11.8	19.7/13.5	35.1/19.7	81.5/40.6
International	**11.7/6.7**	9.6/3.6	3.2/1.7	2.8/1.3	8.4/2.7
Total	**37.2/23.3**	36.8/20.8	33.8/20.5	50.4/27.2	103.4/49.8
Wells Drilled (gross/net)					
Canadian provinces – exploratory wells					
Oil	**10/9**	20/14	20/11	21/13	42/30
Gas	**18/16**	35/26	10/6	34/15	50/27
Dry	**27/21**	33/22	35/25	42/24	75/53
	55/46	88/62	65/42	97/52	167/110
Canadian provinces – development wells					
Oil	**96/23**	176/91	199/74	283/51	482/169
Gas	**65/28**	90/39	45/27	32/10	47/26
Oil sands	**20/6**	266/133	75/38	4/2	–/–
Dry	**11/5**	15/7	20/13	14/7	48/21
	192/62	547/270	339/152	333/70	577/216
Frontier Canada and international					
– exploratory and development wells					
Oil	**6/2**	3/2	3/1	9/2	16/4
Gas	**1/0**	1/0	–/–	9/3	10/4
Dry	**4/2**	8/2	6/2	19/6	26/7
	11/4	12/4	9/3	37/11	52/15
Total	**258/112**	647/336	413/197	467/133	796/341
Proved Reserves					
(net, before royalties/after royalties)					
Natural gas (trillions of cubic feet)	**3.3/2.7**	3.5/2.8	3.4/2.8	3.4/2.7	3.5/2.8
Sulphur (millions of tons)	**4.6/3.9**	5.6/4.7	5.3/4.5	5.1/4.3	5.4/4.5
Crude oil and natural gas liquids					
(millions of barrels)					
Conventional crude oil	**226.8/185.3**	278.3/229.4	264.7/214.7	275.2/218.5	288.2/218.4
Synthetic crude oil	**250.0/212.5**	257.1/218.6	249.9/212.4	246.6/209.5	245.9/209.1
Natural gas liquids	**50.5/37.0**	46.3/36.9	45.1/34.1	44.8/33.1	46.8/34.6
Total	**527.3/434.8**	581.7/484.9	559.7/461.2	566.6/461.1	580.9/462.1

	1989	1988	1987	1986	1985
Daily Production					
(net, before royalties/after royalties)					
Natural gas (millions of cubic feet)	**570.8/460.1**	487.9/395.4	437.2/353.7	360.7/289.3	410.8/324.4
Sulphur (thousands of tons)	**1.0/.8**	1.0/.8	.9/.8	.8/.7	.9/.8
Crude oil and field natural gas liquids (thousands of barrels)					
Conventional crude oil	**62.3/51.7**	66.2/54.1	66.8/54.0	67.0/54.0	65.2/49.7
Synthetic crude oil	**25.2/24.6**	25.6/25.0	23.3/22.7	22.0/21.5	21.9/19.6
Field natural gas liquids	**12.9/9.5**	13.4/9.7	13.2/10.0	13.2/9.6	11.0/8.1
Total	**100.4/85.8**	105.2/88.8	103.3/86.7	102.2/85.1	98.1/77.4
Natural gas liquids production from straddle plants including ethane (thousands of barrels)	**44.8**	40.4	39.6	40.9	35.8
Average sale prices					
Crude oil and field natural gas liquids ($ per barrel)	**18.86**	15.78	22.25	18.27	36.05
Natural gas ($ per thousand cubic feet)	**1.48**	1.61	1.63	2.11	2.45
Marketing					
Retail outlets at year end	**3 295**	3 429	3 677	3 844	3 965
Petroleum products sales (thousands of cubic metres per day)					
Gasolines	**20.1**	19.4	20.3	20.3	16.3
Distillates	**15.8**	16.1	16.7	16.2	12.2
Heavy fuel oil	**2.7**	2.6	2.5	2.4	2.6
Other including petrochemicals	**5.8**	5.7	6.1	5.5	4.4
Total	**44.4**	43.8	45.6	44.4	35.5
Refining					
Refinery crude capacity at year end (thousands of cubic metres per day)	**54.2**	60.6	64.0	64.0	46.2
Crude oil processed by Petro-Canada (thousands of cubic metres per day)	**46.5**	48.5	48.4	47.2	34.2
Average refinery utilization (per cent) (Note 3)	**86**	77	76	74	78
Employees					
Number at year end	**6 468**	7 373	7 204	7 740	9 747

Notes:

1. Operating results are included from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the Edmonton refinery.
2. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
3. Average refinery utilization takes into account, where applicable, changes in refinery crude capacity that occured during the year.

Board of Directors

†* **Wilbert (Bill) H. Hopper, O.C.**
Chairman of the Board
and Chief Executive Officer
Petro-Canada
Calgary, Alberta

† **Edward M. Lakusta**
President
and Chief Operating Officer
Petro-Canada
Calgary, Alberta

† **Alfred E. Barroll**
President
A.E. Barroll Resource
Consultants Ltd.
Calgary, Alberta

H. Reuben Cohen, Q.C.
Barrister and Solicitor
Moncton, New Brunswick

Harbanse S. Doman
President and Chairman
of the Board
Doman Industries Limited
Duncan, British Columbia

Anne R. Dubin, Q.C.
Senior Partner
Tory, Tory, DesLauriers
and Binnington
Barristers and Solicitors
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† **William McBurney Elliott, Q.C.**
Counsel
MacPherson, Leslie and
Tyerman
Barristers and Solicitors
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* **Claude Fontaine**
Senior Partner
Ogilvy, Renault
Barristers and Solicitors
Montreal, Quebec

John H. Lundrigan
President
Lundrigan Consulting Services
Limited
St. John's, Newfoundland

* **Helen M. Meyer**
Financial Executive
Toronto, Ontario

* **Jocelyne Pelchat**
President and Chief Operating
Officer
Provost/Ronalds-Reynolds Inc.
Montreal, Quebec

* Audit Committee member
† Executive Committee member

† **David E. Read**
President
Read Restaurants Ltd.
Dartmouth, Nova Scotia

† **William W. Siebens**
President
Candor Investments Ltd.
Calgary, Alberta

* **Arni C. Thorsteinson**
President
Shelter Canadian Holdings Limited
Winnipeg, Manitoba

Walter P. Twinn
Business Manager
Sawridge Indian Band
Slave Lake, Alberta

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Wilbert (Bill) H. Hopper, O.C.
Chairman of the Board
and Chief Executive Officer

Edward M. Lakusta
President
and Chief Operating Officer

James M. Stanford
President
Petro-Canada Resources Division

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